[J-72-2021] [MO: Wecht, J.]
IN THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

EDWARD J. O'DONNELL	:	No. 8 WAP 2021
	:	
v.	:	Appeal from the Order of the Commonwealth Court entered December 18, 2020 at No. 880 C.D. 2019, reversing the Order of the Court of Common Pleas of Allegheny County entered June 11, 2019 at No. SA-17-001040.
ALLEGHENY COUNTY NORTH TAX COLLECTION COMMITTEE, AND BOROUGH OF FOX CHAPEL AND FOX CHAPEL AREA SCHOOL DISTRICT	:	
	:	ARGUED: October 27, 2021
APPEAL OF: BOROUGH OF FOX CHAPEL AND FOX CHAPEL AREA SCHOOL DISTRICT	:	

DISSENTING OPINION

JUSTICE TODD

The majority finds that the definition of "compensation" in Section 303 of the Tax Reform Code, 72 P.S. § 7303(a)(1)(i) ("Tax Code"), unambiguously includes *qui tam* payments, rendering such payments "earned income" subject to taxation under the Local Tax Enabling Act, 53 P.S. § 6924.501 ("LTEA"). Unlike the majority, but consistent with the Commonwealth Court below, in my view, the relevant language of the Tax Code is sufficiently ambiguous in this regard such that the taxpayer herein should benefit from the principle that tax statutes be "construed most strongly and strictly against the Government and any reasonable doubt must be resolved in favor of the taxpayer." *In re Good's Estate*, 182 A.2d 721, 723 (Pa. 1962); *see* 1 Pa.C.S. § 1928(b)(3) (provisions imposing taxes are to be strictly construed). Thus, I would construe the statute in favor of O'Donnell and

conclude that *qui tam* payments do not constitute compensation under Section 303(a)(1)(1). Accordingly, I must dissent.

As the majority notes, Section 303 sets forth eight different classes of income subject to state personal income tax, including, as pertinent herein, "compensation," which it defines as "[a]ll salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered whether directly or through an agent." 72 P.S. § 7303(a)(1)(i). Neither party disputes that *qui tam* payments are not explicitly listed in this definition. Nevertheless, the majority concludes that *qui tam* awards unequivocally constitute taxable compensation under Section 303, finding definitively that they are an incentive payment. I do not agree that the proper characterization of *qui tam* awards for tax purposes is so clear.

The majority finds that *qui tam* awards are an incentive payment, and, thus, compensation under Section 303, because they financially incentivize a relator to make a claim under the False Claims Act ("FCA") and to provide the federal government with information related thereto. For the reasons the majority offers, this is certainly a reasonable interpretation of Section 303. In my view, however, there are other reasonable interpretations of the Tax Code implicated herein. First, the Tax Code's definition of compensation as imported into the LTEA reasonably suggests an employment relationship is required, which is absent here. Second, and regardless, a relator's actions in connection with a *qui tam* lawsuit can reasonably be viewed as providing services to the relator himself, and not to the federal government.

Distilled to its essence, Section 303 provides that "compensation is something which is received for services rendered." *Commonwealth v. Staley*, 381 A.2d 1280, 1282 (Pa. 1978). While Section 303 contains no express requirement that compensation must

be received through an employment relationship, and although Section 303 does not define "services," the other categories of compensation included in the provision — salaries, wages, commissions, bonuses, incentive payments, fees, and tips — appear to have an employment nexus, suggesting that the catch-all language "similar remuneration received for services rendered" does as well.

Furthermore, in defining "earned income," Section 501 of the LTEA expressly references both the definition of compensation in Section 303 of the Tax Code *and* the Code's accompanying rules and regulations. *See* 53 P.S. § 6924.501. The above employment-focused view of the Tax Code is consistent with the definition of "compensation" in its controlling regulation, which focuses more overtly on an employment relationship:

> Compensation includes items of remuneration received, directly or through an agent, in cash or in property, based on payroll periods or piecework, for services rendered as an employee or casual employee, agent or officer of an individual, partnership, business or nonprofit corporation, or government agency. These items include salaries, wages, commissions, bonuses, stock options, incentive payments, fees, tips, dismissal, termination or severance payments, early retirement incentive payments and other additional compensation contingent upon retirement, including payments in excess of the scheduled or customary salaries provided for those who are not terminating service, rewards, vacation and holiday pay, paid leaves of absence, payments for unused vacation or sick leave, tax assumed by the employer, or casual employer signing bonuses, amounts received under employee benefit plans and deferred compensation arrangements, and other remuneration received for services rendered.

61 Pa. Code § 101.6(a). In my view, the ambiguity in this regard – whether "compensation" requires an employment nexus – redounds in O'Donnell's favor as I reject

the Taxing Authorities' argument[1] that a *qui tam* relator's role in initiating and participating in the litigation renders them an employee or agent of the government.

At any rate, regardless of whether the remuneration is deemed to be an incentive payment as the majority concludes, it is undisputed that under the Tax Code such remuneration must be given in exchange for "services rendered." 72 P.S. § 7303(a)(1)(i). In one respect, and as the majority illustrates, the *qui tam* relator's actions in initiating and participating in the *qui tam* action under the FCA and providing the federal government with information related thereto can be viewed as a service to the federal government, as the relator's actions in this regard aid the federal government in identifying and combating fraud, and as the relator may receive a percentage of the proceeds of the action or settlement based upon "the extent to which [he or she] substantially contributed to the prosecution of the action." 31 U.S.C. § 3730(d)(1).

On the other hand, however, as the high Court observed in *Stevens*, a *qui tam* relator "has a concrete private interest in the outcome of the suit." *Vermont Agency of Natural Resources v. Stevens*, 529 U.S. 765, 772 (2000) (internal quotation marks omitted). Indeed, the Court observed the FCA provides that:

> [a] person may bring a civil action for a violation of section 3729 *for the person and for the United States Government,*" § 3730(b) (emphasis added); gives the relator "the right to continue as a party to the action" even when the Government itself has assumed "primary responsibility" for prosecuting it, § 3730(c)(1); entitles the relator to a hearing before the Government's voluntary dismissal of the suit, § 3730(c)(2)(A); and prohibits the Government from settling the suit over the relator's objection without a judicial determination of "fair[ness], adequa[cy] and reasonable[ness]," § 3730(c)(2)(B).

---

[1] Like the majority, I refer to the Borough of Fox Chapel and the Fox Chapel School District collectively as the "Taxing Authorities".

Id. at 772 (quoting 31 U.S.C. § 3730). As a result, regardless of the government's participation, the relator remains substantially personally vested in the litigation. Moreover, as the high Court also found, the "FCA can reasonably be regarded as effecting a partial assignment of the Government's damages claim," providing the relator with a direct financial interest in the outcome of the case as a plaintiff. *Id.* at 773. In my view, a plaintiff in a lawsuit, brought in his name, with (in some circumstances) exclusive control over it, who is personally invested in its outcome, and who has a direct financial interest in the damages award funded not by the government but by the defendant, can be viewed as principally serving himself and not the federal government. From this perspective, a *qui tam* plaintiff receiving an award is not being remunerated for services rendered under the Tax Code.

Again, I accept that the majority's conclusion that a *qui tam* plaintiff provides services to the federal government under Section 303 to be a reasonable one. But, in my view, the alternative interpretation – that a *qui tam* plaintiff is principally serving himself and not the government – is also reasonable. As a result, I consider Section 303 to be ambiguous in this respect as well.

Herein, Taxing Authorities advanced no less than three differing and inconsistent theories as to why they consider *qui tam* payments to be taxable compensation: that the *qui tam* award is compensation for services O'Donnell rendered as a *qui tam* plaintiff generally; that it is compensation for services O'Donnell rendered while working as an agent or employee of the federal government; and that it is compensation in the form of an incentive payment. For the above reasons, I find the relevant provisions of the Tax Code to be susceptible to multiple reasonable, but conflicting, interpretations. Yet, tax laws "are to be construed most strictly against the government and most favorably to the taxpayer, and a citizen cannot be subjected to a special burden without clear warrant of

law." *In re Husband's Estate*, 175 A. 503, 506 (Pa. 1934). Because I consider the tax consequences of *qui tam* payments under Section 303 to be less than clear, I would find in favor of O'Donnell. Accordingly, I dissent.

Chief Justice Baer and Justice Donohue join this dissenting opinion.

[J-72-2021]
IN THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

BAER, C.J., SAYLOR, TODD, DONOHUE, DOUGHERTY, WECHT, MUNDY, JJ.

EDWARD J. O'DONNELL v. ALLEGHENY COUNTY NORTH TAX COLLECTION COMMITTEE, AND BOROUGH OF FOX CHAPEL AND FOX CHAPEL AREA SCHOOL DISTRICT APPEAL OF: BOROUGH OF FOX CHAPEL AND FOX CHAPEL AREA SCHOOL DISTRICT	No. 8 WAP 2021 Appeal from the Order of the Commonwealth Court entered December 18, 2020 at No. 880 C.D. 2019, reversing the Order of the Court of Common Pleas of Allegheny County entered June 11, 2019 at No. SA-17-001040. ARGUED: October 27, 2021

OPINION

JUSTICE WECHT **DECIDED: DECEMBER 27, 2021**

After observing fraud perpetrated by his employer against the United States of America, Edward J. O'Donnell stepped into the role of "relator" (colloquially, a "whistleblower") under the federal False Claims Act ("FCA"), 31 U.S.C. §§ 3729-3732.[1]

---

[1] The FCA "was enacted in 1863 with the principal goal of stopping the massive frauds perpetrated by large private contractors during the Civil War." *Vermont Agency of Natural Res. v. U.S. ex rel Stevens*, 529 U.S. 765, 791 (2000) (internal quotation marks omitted). Section 3729 of the FCA imposes civil liability upon "any person" who "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" to the United States government. 31 U.S.C. § 3729(a)(1)(A). Pursuant to Section 3730 of the FCA, a private person, known as a relator, may bring a qui tam action against the alleged false claimant on behalf of the federal government, *id.* § 3730(b)(1). The federal government may choose to intervene in the action and take over the

In this whistleblower capacity, O'Donnell filed a federal qui tam action[2] in 2014 alleging, on behalf of the United States, that his employer violated the FCA. As a financial incentive to take on this role, the FCA provides relators with a portion of any award that the federal government obtains in the qui tam action. The United States government ultimately settled with O'Donnell's employer. O'Donnell received a 16% share of the settlement, or $34,560,000. The question before the Court today is whether this qui tam award is taxable in Pennsylvania as compensation under Section 303 of our Tax Reform Code, 72 P.S. § 7303. For the reasons that follow, we hold that it is. Thus, we reverse the order of the Commonwealth Court.

The parties have stipulated to the facts that underlie this matter. O'Donnell was a resident of the Borough of Fox Chapel ("Borough") and lived within the Fox Chapel Area School District ("School District") (collectively, "Taxing Authorities") during the 2014 tax year. In June 2014, O'Donnell filed a qui tam action in federal court, alleging that his employer, a financial institution, violated the FCA. The federal government intervened in the action and began prosecuting the case. Ultimately, in August 2014, the Department of Justice, acting on behalf of the United States, entered into a global settlement agreement with O'Donnell's employer, which, *inter alia*, resolved the claims related to O'Donnell's allegations. Thereafter, in December 2014, the United States government

---

prosecution of the case. *Id.* § 3730(b)(4). If the action is successful, the relator receives a share of the proceeds of the action or settlement of the claim, regardless of the federal government's involvement. *Id.* § 3730(d).

[2] Qui tam comes from the Latin phrase "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," meaning "who pursues this action on our Lord the King's behalf as well as his own." *Vermont Agency of Natural Res.*, 529 U.S. at 768 n.1 (internal quotation marks omitted).

entered into a settlement agreement with O'Donnell, whereby O'Donnell received a 16% share of the total settlement.

Initially, O'Donnell reported this whistleblower payment as compensation on his 2014 Pennsylvania personal income tax return, and paid taxes accordingly. However, O'Donnell later filed a petition for refund. On September 26, 2018, the Pennsylvania Board of Finance and Revenue ("the Board") ordered the Pennsylvania Department of Revenue ("the Department") to refund to O'Donnell the personal income tax which he had paid on the whistleblower payment. The Department subsequently filed a petition for review in the Commonwealth Court, challenging the Board's decision and order. That petition is currently before the Commonwealth Court and has been stayed pending resolution of the present case.

Meanwhile, Keystone Collections Group ("Keystone"), the tax servicer for the School District and the Borough, discovered that O'Donnell did not file a local earned income tax return for the 2014 tax year. On May 24, 2017, after referencing the earnings that O'Donnell reported to the Department in his initial personal income tax return for 2014, Keystone mailed O'Donnell a notice that his local earned income tax for that year was delinquent in the amount of $437,194.92, consisting of $345,599.92 in earned income tax, $51,840 in statutory interest and penalties, and $39,755 in costs. On August 21, 2017, O'Donnell filed a petition for administrative appeal, followed, on September 28, 2017, by a "Supplement to Petition for Appeal." In these submissions, O'Donnell alleged, *inter alia*, that the whistleblower payment was not taxable earned income subject to the School District's Earned Income Tax Resolution or the Borough's Earned Income Tax Ordinance for the 2014 tax year.

By way of background, the School District and the Borough derive their authority to impose earned income tax from the Local Tax Enabling Act ("LTEA"), 53 P.S. §§ 6924.101 *et seq.*, which authorizes certain political subdivisions to impose a tax on the earned income of their residents. Relevantly, pursuant to the LTEA, the School District and the Borough are members of the Allegheny County North Tax Collection District, and they levy earned income tax at the combined effective rate of 1%.

The Borough's Earned Income Tax Ordinance in effect during the 2014 tax year incorporates by reference the definitions set forth in the LTEA, including the definition of "earned income."[3] The School District also levies a tax on "earned income" consistent with the definition in the LTEA, as the School District derives its authority to collect earned income tax exclusively from that Act.[4] The LTEA defines "earned income," in pertinent part, as "[t]he compensation as required to be reported to or as determined by the [Department] under section 303 of the . . . Tax Reform Code of 1971 [("Tax Code")], and rules and regulations promulgated under that section." 53 P.S. § 6924.501 (footnote omitted).

Section 303 of the Tax Code, in turn, defines "compensation," in relevant part, as:

> All salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered whether directly or through an agent and whether in cash or in property . . . .

72 P.S. § 7303(a)(1)(i). Additionally, the Department's regulations provide, in relevant part, as follows:

---

3 *See* Borough of Fox Chapel Ordinance No. 687 at § 2.

4 *See Ski Roundtop, Inc. v. Fairfield Area Sch. Dist.*, 533 A.2d 828, 831 (Pa. Cmwlth. 1987).

> Compensation includes items of remuneration received, directly or through an agent, in cash or in property, based on payroll periods or piecework, for services rendered as an employee or casual employee, agent or officer of an individual, partnership, business or nonprofit corporation, or government agency. These items include salaries, wages, commissions, bonuses, stock options, incentive payments, fees, tips, dismissal, termination or severance payments, early retirement incentive payments and other additional compensation contingent upon retirement, including payments in excess of the scheduled or customary salaries provided for those who are not terminating service, rewards, vacation and holiday pay, paid leaves of absence, payments for unused vacation or sick leave, tax assumed by the employer, or casual employer signing bonuses, amounts received under employee benefit plans and deferred compensation arrangements, and other remuneration received for services rendered.

61 Pa. Code § 101.6(a).

Relying upon the above provisions, the Appeals Board of the Allegheny County North Tax Collection Committee ("Appeals Board") denied the petition for administrative appeal, concluding, *inter alia*, that O'Donnell's whistleblower payment constituted compensation and, thus, was taxable earned income subject to the School District's Earned Income Tax Resolution and the Borough's Earned Income Tax Ordinance for the 2014 tax year. In so finding, the Appeals Board explained that:

> By bringing his Qui Tam action on behalf of the United States of America, . . . Taxpayer acted as an "agent" of the United States Government pursuant to 61 Pa. Code § 101.6(a), and the compensation received as a result of his services rendered constitute[s] taxable earned income at the local level.[5]

Thus, the Appeals Board denied relief.

On December 13, 2017, O'Donnell appealed the decision to the Allegheny County Court of Common Pleas, which affirmed, finding that the whistleblower payment was taxable as earned income at the local level. In so doing, the court looked to the definition

---

[5] Decision of the Appeals Board of the Allegheny County North Tax Collection Committee, 11/16/17, at 2.

of "compensation" in the Department's regulation and applied that definition to the instant matter, explaining that, to be considered compensation for tax purposes, the payment must be for services rendered as an "employee or casual employee, agent or officer of an individual, partnership, business or nonprofit corporation, or government agency."[6] The court determined that, here: O'Donnell acted as an agent of the federal government when he filed the qui tam action, as the FCA requires the whistleblower in a qui tam action to bring the action on his own behalf and on behalf of the United States government, *see* 31 U.S.C. § 3730(b)(1); O'Donnell complied with that directive when he affirmatively filed the lawsuit on behalf of the United States; and the amount of money that O'Donnell was to receive was contingent upon the success of the lawsuit, thus evincing a relationship with the federal government. Accordingly, the court concluded that, because O'Donnell received the whistleblower payment while acting as an agent of the federal government, the payment constituted taxable compensation. Thus, the court entered judgment against O'Donnell in the amount of $437,194.92. O'Donnell filed a petition for review in the Commonwealth Court.

An *en banc* panel of the Commonwealth Court reversed. *O'Donnell v. Allegheny Cnty. N. Tax Collection Comm.*, 880 C.D. 2019, 2020 WL 7413634 (Pa. Cmwlth. filed Dec. 18, 2020).[7] Preliminarily, the court explained that the Borough's earned income tax

---

6 Tr. Ct. Op., 6/11/2019, at 3 (quoting 61 Pa. Code § 101.6(a)).

7 Before the courts below, O'Donnell also alleged that his underlying petition for administrative appeal should be deemed approved because, he claimed, his appeal was not heard and decided by the Appeals Board within sixty days of the date the petition was received, as required by Section 8433 of the Local Taxpayers Bill of Rights, 53 Pa.C.S. § 8433. The trial court rejected this argument, and the Commonwealth Court concluded that the trial court's determination in this regard was supported by the evidence of record. As this issue is not before us, we do not address it.

ordinance expressly incorporates the definitions contained in Section 501 of the LTEA, which defines "earned income" as "[t]he compensation as required to be reported to or as determined by the [Department] under section 303 [72 P.S. § 7303] of . . . the Tax Reform Code of 1971, and rules and regulations promulgated under that section." *Id.* at 6 (quoting 53 P.S. § 6924.501). As a result, the court next turned to Section 303 of the Tax Code, observing that the Tax Code sets forth eight classes of income to be taxed as personal income in Pennsylvania, including, as relevant herein, "compensation," *id.* (citing 72 P.S. § 7303), defined in the Tax Code as "salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered, whether directly or through an agent, and whether in cash or property." *Id.* at 6 n.10 (quoting 72 P.S. § 7301(d)).

Given that qui tam payments are not explicitly included in the definition of "compensation" under either the Tax Code or the Department's regulations, the court opined that "the determination of whether such a recovery is taxable for [earned income tax] purposes comes down to whether said recovery fits, or arguably fits, into one of the kinds of compensation contemplated in the Tax Code." *Id.* at 21. Emphasizing that, to be considered "compensation," a payment must be made "for services rendered as an employee or casual employee, agent or officer," *id.* (quoting 61 Pa. Code § 101.6(a)) (emphasis omitted), the court reasoned that, here, O'Donnell must have received the whistleblower payment for services rendered, which necessarily required either that he was employed by the federal government or that he served as its agent. The court found that O'Donnell was neither.

In this regard, the court noted that, in determining whether someone is an employee for purposes of workers' compensation or unemployment compensation, courts consider the degree to which an individual's efforts were under the control of another. Applying that standard to determine whether O'Donnell was an employee of the federal government, the court observed that O'Donnell himself initiated the qui tam litigation, and the federal government had little to no control over him, as O'Donnell could have moved forward with the litigation on his own if the federal government had elected not to pursue the case. Thus, the court concluded that O'Donnell was not an employee of the federal government.

The court likewise found that O'Donnell was not an agent of the United States of America, given that the Department of Justice assumed primary responsibility for prosecuting the qui tam action once it decided to proceed with the litigation, and whistleblowers are not vested with any governmental power. In support of its conclusion, the court rejected any attempt to "shoehorn Taxpayer's qui tam recovery into a type of compensation that is taxable" for earned income tax purposes, stressing that the Commonwealth's tax laws are to be narrowly and strictly construed against the government and in favor of the taxpayer. *Id.* at 22.

The court next considered whether the whistleblower payment was taxable under Pennsylvania law as an award. The court determined that it was not. While Taxing Authorities likened the qui tam proceeds to an award of damages in a lawsuit, the court disagreed, explaining that, although O'Donnell received the whistleblower payment as a result of initiating the lawsuit, the recovery was not tied to any damages sustained by O'Donnell and, thus, was "not part of an effort to make [him] whole." *Id.* at 10. The court

further found that the whistleblower payment was not a reward for O'Donnell's efforts, observing that rewards typically are established and announced as an incentive for a particular outcome, whereas, here, there was no guarantee that O'Donnell would receive any financial recovery for his efforts.

Emphasizing that the General Assembly has had "ample time" since the FCA's adoption in 1863 to include the proceeds from qui tam recoveries in the Commonwealth's tax laws if it wished to do so, the court concluded that the whistleblower payment was not taxable for earned income tax purposes. The court opined that "[i]t seems incongruous that, on the one hand, we would encourage individuals to ferret out government waste, and, on the other hand, we would punish them by taxing the proceeds for doing so." *Id.* at 10. Accordingly, the Commonwealth Court reversed the trial court's order.

Judge Ellen Ceisler authored a concurring and dissenting opinion, joined by Judge Renée Cohn Jubelirer. Judge Ceisler disagreed with the majority's conclusion that the whistleblower payment did not constitute taxable income for local earned income tax purposes. In Judge Ceisler's view, the definition of "compensation" set forth in Section 303(a)(1)(i) of the Tax Code, rather than the Department's administrative regulation, controlled. Judge Ceisler reasoned that, because the definition set forth in Section 303 is broader than the regulation and does not contain language making the taxability of remuneration contingent on the recipient's employment status, the question of whether O'Donnell was an employee or agent of the federal government was not relevant to the question of whether the whistleblower payment constituted compensation. Rather, observing that the purpose of a qui tam cause of action is to "incentivize private citizens to aid the federal government in rooting out fraud and corruption," Judge Ceisler explained

that she would characterize the whistleblower payment as an "incentive payment," which is listed as compensation under Section 303(a)(1)(i) of the Tax Code, and, thus, is taxable income.[8] Judge Ceisler emphasized that, here, O'Donnell was aware when he initiated the qui tam action that he could benefit financially from it, thus incentivizing him to bring the action in the first place and to actively assist the federal government once it began prosecuting the case. As a result, Judge Ceisler would have affirmed the trial court's order.

Taxing Authorities subsequently filed a petition for allowance of appeal. We granted allocatur in order to consider the question of whether a qui tam payment constitutes taxable "earned income" under the LTEA.

Taxing Authorities assert that the Commonwealth Court erred in holding that the whistleblower payment is not compensation and, thus, not taxable earned income. They note that the United States government taxes qui tam payments, and they suggest that all other states do as well. As a preliminary matter, Taxing Authorities take issue with the Commonwealth Court's reliance on the definition of "compensation" found in the regulation, noting that the regulation requires that there be a nexus between the payor and the recipient of the payment in order for the payment to be considered compensation—*i.e.*, the remuneration must be received for "services rendered as an employee or casual employee, agent or officer of an individual, partnership, business or nonprofit corporation, or government entity"[9]—a requirement which is not included in the Tax Code's definition of compensation. Indeed, Taxing Authorities observe that the

---

8 *Id.* at 12 (Ceisler, J., concurring and dissenting).

9 Appellants' Brief at 14-15 (quoting 61 Pa. Code § 101.6(a)).

statutory definition merely defines compensation as "salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered whether directly or through an agent."[10]

Taxing Authorities maintain that applying the relationship requirement from the regulation would render portions of the Tax Code's definition inoperable, noting, for example, that the statute lists "commissions" and "tips" as forms of compensation, but that it would be highly unlikely that the payor and recipient of a tip would have a relationship of the sort sufficient to satisfy the regulation's requirement. Likewise, Taxing Authorities contend that this Court previously found in *Commonwealth v. Staley*, 381 A.2d 1280 (Pa. 1978), that commissions earned by a life insurance agent are taxable compensation even though they are not earned through an employer/employee relationship. Taxing Authorities argue that, because the regulation is narrower than—and arguably at odds with—the more expansive definition in the Tax Code, the statutory definition of compensation should control, emphasizing that "the power of an administrative agency to prescribe rules and regulations under a statute is not the power to make law, but only the power to adopt regulations to carry into effect the will of the Legislature as expressed by the statute."[11]

Looking solely to the definition contained in the Tax Code, Taxing Authorities contend that the whistleblower payment is indeed compensation and, thus, taxable.

---

[10] *Id.* at 13 (quoting 72 P.S. § 7303(a)(1)(i)).

[11] Appellants' Brief at 15-16 (quoting *Commonwealth v. DiMeglio*, 122 A.2d 77, 80 (Pa. 1956)).

Specifically, Taxing Authorities claim that the payment is an incentive, which, they note, is a payment made for the purpose of inducing performance and is explicitly listed in the statutory definition of compensation. In this regard, Taxing Authorities argue that qui tam awards or settlements incentivize whistleblowing, highlighting that, under the FCA, the greater the whistleblower's effort and level of participation in the case, the greater his or her possible share of an award or settlement.[12] Taxing Authorities suggest that the possibility of receiving a share of the proceeds of a qui tam award or settlement in this case induced O'Donnell to bring the action against his employer and to assist the federal government in its prosecution thereof, as exhibited by his "substantial contribution to the prosecution of the action," which resulted in him receiving a 16% share of the settlement.[13]

Alternatively, Taxing Authorities assert that the whistleblower payment constitutes "similar remuneration received for services rendered" under the Tax Code's definition of compensation. 72 P.S. § 7303(a)(1)(i). Taxing Authorities characterize this language as a "limited catch-all" provision that includes other payments similar to those explicitly recognized as compensation in the definition, such as stock options, which this Court has found to be "other compensation . . . for services rendered," and, thus, taxable earned income under the LTEA, notwithstanding that these payments are not specifically listed in the Tax Code's definition. *See Marchlen v. Twp. of Mt. Lebanon*, 746 A.2d 566, 569 (Pa. 2000). Indeed, consistent with this interpretation, Taxing Authorities stress that the Department itself has stated that, "if a particular item of income is not explicitly listed in

---

12 *Id.* at 29 (citing 31 U.S.C. § 3730(d)(1)).

13 *Id.* at 31 (citing 31 U.S.C. § 3730(d)(1)).

the definition . . . the relevant inquiry is 'whether the payment is a substitute for income that would have been included in one of the eight classes of income subject to Pennsylvania Personal Income Tax.'"[14]

Here, noting the United States' strong interest in "identifying and ferreting out fraud," Taxing Authorities maintain that whistleblowers provide valuable services to the federal government by initiating and participating in qui tam actions under the FCA and providing the government with information related thereto.[15] Taxing Authorities further assert that a majority of federal courts have held that "a qui tam award is given in exchange for information and services and is based entirely on the whistleblower's information and personal efforts," which Taxing Authorities suggest supports a similar finding under Pennsylvania law.[16] Accordingly, Taxing Authorities contend that qui tam payments are indeed rewards for those services, or bounties, and likewise fall within the definition's catch-all provision, rendering the whistleblower payment taxable compensation on this basis as well.

Finally, Taxing Authorities claim that, even if we were to apply the regulation, the whistleblower payment would still be taxable compensation because O'Donnell acted as an agent of the federal government when he brought the qui tam lawsuit. In so asserting, Taxing Authorities note that our Court has recognized the existence of an agency relationship based upon the following three elements: "(1) the manifestation by the

---

14 Appellants' Brief at 26-27 (quoting Pa. Ltr. Rul. PIT-06-007).

15 *Id.*

16 *Id.* at 28 (citing *Alderson v. United States*, 718 F.Supp.2d 1186, 1190-91 (C.D. Cal. 2010)).

principal that the agent shall act for him, (2) the agent's acceptance of the undertaking, and (3) the understanding of the parties that the principal is to be in control of the undertaking."[17]

Applying that standard to the facts of this case, Taxing Authorities argue that the first element of an agency relationship is satisfied because the United States government statutorily manifested its intent for a private individual to act on its behalf by expressly authorizing a person to bring a civil action for violating the FCA in Section 3730(b)(1) and requiring the action to be "brought in the name of the Government." 31 U.S.C. § 3730(b)(1). Next, Taxing Authorities suggest that, by filing the action in this case and disclosing all material evidence and information to the federal government, O'Donnell accepted the undertaking authorized by the FCA, thereby satisfying the second element of an agency relationship. Finally, Taxing Authorities assert that the third element of the agency relationship is satisfied in this case because the FCA makes clear that the government is to be in control of the undertaking. In this regard, Taxing Authorities note: that the qui tam action may only be dismissed with the government's consent, *see id.*; that the government is "not . . . bound by an act of the person bringing the action," *id.* § 3730(c)(1); that the government may settle or dismiss the action without the consent of the person bringing the action, *id.* § 3730(c)(2)(A)-(B); and that the government may impose limitations upon the involvement of the person who initiated the action, *id.* § 3730(c)(2)(C). Taxing Authorities emphasize that the government's dominant role over

---

17 *Id.* at 20 (quoting *Basile v. H&R Block, Inc.*, 761 A.2d 1115, 1120 (Pa. 2000)).

the whistleblower in a qui tam action confirms the existence of an agency relationship between the government and the taxpayer herein.[18]

Accordingly, Taxing Authorities maintain that the whistleblower payment is taxable compensation under the LTEA and Tax Code, just as such payments are taxable for federal income tax purposes. Thus, Taxing Authorities ask us to reverse the Commonwealth Court's decision and to enter judgment in their favor in the amount of $437,194.92.[19]

---

[18] Additionally, Taxing Authorities note that the regulation describes compensation as including services rendered as a "casual employee," which the regulation defines as "an individual who performs, or by agreement, refrains from performing, any service of whatever nature and is not an employe [*sic*]." 61 Pa. Code § 101.1. Seemingly suggesting that O'Donnell was a casual employee of the federal government, Taxing Authorities argue that the Commonwealth Court "erred by not examining the facts of this case in light of the broad regulatory definition of a casual employee." Appellants' Brief at 15 n.4. In response, O'Donnell asserts that Taxing Authorities failed to raise this argument below, rendering it waived.

[19] The Department has filed an *amicus curiae* brief in support of Taxing Authorities in this matter, noting that it has a direct interest in the outcome of this case because it is vested with the authority "to determine the tax liability of taxpayers subject to personal income tax," Department's Brief at 2 (citing 72 P.S. §§ 7338, 7355), and to "prescribe, adopt, promulgate and enforce rules and regulations relating to any matter or thing pertaining to the administration and enforcement of the provisions of [the Tax Code] and the collection of taxes imposed by Article III [of the Tax Code]," *id.* at 3 (quoting 72 P.S. § 7354).

The arguments raised in the Department's brief are similar to those advanced by Taxing Authorities. The Department also asserts that the regulation does not specifically define the term "compensation," but, rather, provides a "non-exclusive list of remuneration that meets the definition of compensation," as exhibited by the regulation's use of the word "includes" immediately before its list of various types of remuneration. *Id.* at 6-7. Thus, the Department maintains that the regulation's reference to remuneration in the context of employer/employee and principal/agent relationships is not a limitation on the scope of what is considered compensation under the Tax Code, but, instead, is an example of "common . . . items that qualify as compensation." *Id.* at 10.

The Department suggests that its position in this regard is consistent with its longstanding interpretation of the regulation, highlighting that, when it amended its personal income tax

In response, O'Donnell contends that the Commonwealth Court properly concluded that the whistleblower payment is not taxable as earned income. Initially, to the extent that Taxing Authorities suggest that the Tax Code's definition of compensation should control over the regulation, O'Donnell maintains that Taxing Authorities waived that argument by failing to raise it before the lower courts. Indeed, O'Donnell claims that Taxing Authorities argued below only that the whistleblower payment was taxable compensation because O'Donnell received it for services he provided while acting as an agent of the federal government—consistent with the regulation. As a result, O'Donnell argues, Taxing Authorities may not now shift their position and allege that the Tax Code and regulation conflict or that the Tax Code definition should prevail.

In any event, O'Donnell contends, the definitions in the Tax Code and the regulation do not conflict, but, rather, must be read in tandem when determining whether the whistleblower payment constitutes taxable compensation. According to O'Donnell, this is because the Borough and the School District derive their authority to levy and collect an earned income tax from the LTEA, and the LTEA defines "earned income" as "[t]he compensation as required to be reported to . . . the Department . . .under section 303 of . . . the [Tax Code], and rules and regulations promulgated under that section."[20] In light of this language providing that earned income is to be based both on the Tax Code's definition of compensation and the associated rules and regulations, O'Donnell

---

regulations in 1999, it specifically stated that an item of "remuneration received for services is taxable as compensation whether or not the services were rendered as, or the item is received by, an 'employe.' That is why 'compensation' has always been defined so it 'includes' (and is thus not limited to) 'items of remuneration received by an employe [*sic*].'" *Id.* at 7 n.4 (quoting 29 Pa.B. 6250 (Dec. 11, 1999)) (emphasis omitted).

20 Appellee's Brief at 11 (quoting 53 P.S. § 6924.501) (emphasis in original).

stresses that the regulation must indeed be considered in determining whether a payment is taxable compensation. Accordingly, noting that the Tax Code defines compensation, in pertinent part, as remuneration received "for services rendered," 72 P.S. § 7303(a)(1), and that the regulation more specifically provides that compensation includes "items of remuneration received . . . for services rendered as an employee or casual employee, agent or officer," 61 Pa. Code § 101.6(a) (emphasis added), O'Donnell argues that the relevant inquiry in determining whether the whistleblower payment is taxable compensation is whether he received it for services he rendered as an employee or agent of the federal government.

While Taxing Authorities allege that the regulation is at odds with the definition of compensation in the Tax Code and, thus, should not be considered when determining whether a payment is earned income under the LTEA, O'Donnell emphasizes that the regulation existed in 2008, when the General Assembly amended the definition of "earned income" in the LTEA to specifically include both the definition of "compensation" in the Tax Code and the Department's rules and regulations thereunder. Thus, O'Donnell maintains, the General Assembly was well aware of the regulation and its language tying compensation to employer and agent-based relations, and intentionally chose to incorporate it into the LTEA definition. According to O'Donnell, requiring a nexus between compensation and an employer/agency relationship makes sense in this context, as doing so is consistent with the fact that local income tax traditionally is not a tax on all forms of income, but, rather, is more narrowly focused on taxing wages and other forms of payment of this nature. Consequently, O'Donnell argues that, because the regulation is "a duly promulgated regulation of the Department interpreting the definition of

compensation under Section 303 of the [Tax] Code," it must be given appropriate weight and deference unless it is clearly erroneous, inconsistent with the Tax Code, or unreasonable.[21]

Invoking the definition of compensation provided by both the Tax Code and the regulation, O'Donnell argues that the Commonwealth Court properly concluded that he was not an agent or employee of the federal government, and, thus, that the whistleblower payment was not compensation for local income tax purposes. More specifically, O'Donnell asserts that he did not act as an agent of the federal government when he initiated the qui tam action because there was no fiduciary relationship between him and the federal government, and because he lacked any power with respect to the federal government's actions related to the litigation. In this regard, O'Donnell highlights that he had no authority to act on the federal government's behalf with respect to the qui tam action or to bind the federal government with his actions, noting that he "brought the qui tam action first and foremost in his name as a plaintiff seeking redress from the court," *id.* at 22, and that federal courts have specifically held that "a whistleblower is not vested with any governmental power."[22]

While O'Donnell concedes that the FCA requires the action to be brought in the name of the United States of America, he stresses that his mere initiation of the action bound the federal government to nothing, as the United States alone retained the authority to intervene and proceed with the litigation, and Section 3730(c)(1) of the FCA

---

21 Appellee's Brief at 14.

22 *Id.* at 23 (quoting *U.S. ex rel. O'Donnells Against Fraud v. Gen. Elec. Co.*, 41 F.3d 1032, 1041 (6th Cir. 1994)).

specifically provides that "if the Government proceeds with the action, it shall have the primary responsibility for prosecuting the action, and shall not be bound by an act of the person bringing the action."[23] O'Donnell maintains that, when the federal government decides to intervene and proceed with the qui tam action, the government alone holds control over the proceedings, including over the decision of whether to dismiss, litigate, or settle the action, all without the approval of the private plaintiff. O'Donnell asserts that the federal government's decision to intervene and ultimately settle the qui tam action in this case did not create an agency relationship. O'Donnell likewise contends that he was not an employee of the federal government, as the Tax Code defines "employee" as "any individual from whose wages an employer is required under the Internal Revenue Code to withhold Federal income tax," 72 P.S. § 7301(g), and, here, the whistleblower payment was not reported as wages paid to an employee on a federal Form W-2.

O'Donnell posits that, even if he had acted as a federal government agent or employee by bringing the qui tam action, the whistleblower payment still would not be taxable compensation because he did not receive it for services that he rendered to the federal government. Rather, O'Donnell argues, the whistleblower payment was merely an award of the share of the global settlement that he was to receive as a plaintiff in the prosecution of the action, again emphasizing that he brought the qui tam action in his name and initiated the prosecution thereof.

O'Donnell maintains that the United States' treatment of the whistleblower payment for federal income tax purposes suggests that the government did not believe that O'Donnell provided services to it as part of the qui tam action. O'Donnell notes that

---

23 *Id.* at 22 (quoting 31 U.S.C. § 3730(c)(1)) (emphasis omitted).

the whistleblower payment to O'Donnell is reported as "other income" in Box 3 on the federal Form 1099-MISC, a category used to report "prizes and awards that are not for services performed," as opposed to Box 7, in which "prizes and awards for services performed by nonemployees" are reported.[24]

Although O'Donnell concedes that the Internal Revenue Code does not typically inform our analysis of matters concerning Pennsylvania personal income tax, he contends that the manner in which the federal government classified the whistleblower payment for federal income tax purposes is instructive in determining whether the whistleblower payment was for services rendered, inasmuch as "the federal government is the best authority to determine whether a payment is for services."[25] Because the federal government did not consider the whistleblower payment to be reportable for federal income tax purposes as compensation for services rendered, O'Donnell argues, the payment also should not be considered taxable compensation for purposes of Pennsylvania personal income tax or local earned income tax.

Finally, O'Donnell emphasizes that Pennsylvania's method of taxing personal income is unique because, while most other states use either a person's total federal adjusted gross income or his taxable income under the Internal Revenue Code as the base for calculating that individual's state personal income tax, Pennsylvania imposes personal income tax only on payments which fall into certain enumerated classes of income. Accordingly, O'Donnell maintains, because qui tam payments do not fall within

---

24 Appellee's Brief at 28-29 (quoting 2014 Instructions for Form 1099-MISC, 5-6, available at https://www.irs.gov/pub/irs-prior/i1099msc--2014.pdf) (emphasis omitted).

25 *Id.* at 28 (emphasis omitted).

any of these enumerated classes of income, they are not subject to Pennsylvania and local income tax, and other states' treatment of whistleblower payments under their respective personal income tax schemes have no bearing on whether such payments are taxable under the laws of this Commonwealth. O'Donnell argues that this conclusion is "consistent with the well-settled principle that a tax cannot be implied if the income at issue does not stem from any of the eight taxable classes."[26] O'Donnell urges this Court to affirm the Commonwealth Court's decision finding that the whistleblower payment was not taxable compensation under the LTEA.[27]

The question of whether a qui tam payment is considered taxable earned income under the LTEA is a matter of statutory interpretation. As such, our standard of review is *de novo* and our scope of review is plenary. *Commonwealth v. Lynn*, 114 A.3d 796, 817-18 (Pa. 2015). It is well settled that, in interpreting a statute, this Court's objective is to ascertain and give effect to the intent of our General Assembly. 1 Pa.C.S. § 1921(a). The best expression of this intent is found in the statute's plain language. *Cagey v. Commonwealth*, 179 A.3d 458, 462 (Pa. 2018). If the statutory language is "clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." 1 Pa.C.S. § 1921(b).

---

26 *Id*. at 15.

27 While the Department filed an *amicus curiae* brief in support of Taxing Authorities' interpretation of "compensation" under the Tax Code and the regulation, O'Donnell argues that "the Department is bound by the plain language of its own regulations and cannot adopt positions contrary to the language set forth in the [Tax] Code." Appellee's Brief at 16 (citing *Saturday Family LP v. Commonwealth*, 168 A.3d 400, 407 (Pa. Cmwlth. 2017) ("courts need not defer to an administrative agency's interpretation of its own regulation where that interpretation 'is clearly erroneous or inconsistent with the regulation.'")).

We construe words and phrases "according to the rules of grammar and according to their common and approved usage." 1 Pa.C.S. § 1903(a). Here, we can ascertain the legislature's intent and meaning from the plain and unambiguous language of Section 303. "When the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to the rules of statutory interpretation and construction; the statute must be given its plain and obvious meaning." *Commonwealth ex rel. Cartwright v. Cartwright*, 40 A.2d 30, 33 (Pa. 1944).

In Pennsylvania, compensation is taxable under the Local Tax Enabling Act ("LTEA") and the Tax Reform Code. The local earned income tax is assessed pursuant to the LTEA, 53 P.S. §§ 6924.101-6924.901. Taxable "earned income" under the LTEA is defined as "the compensation as required to be reported to . . . the Department of Revenue under [Section 303 of the Tax Reform Code of 1971], and the rules and regulations promulgated under that section . . . ." 53 P.S. § 6924.501. Section 303 of the Tax Reform Code, in turn, defines "compensation" as: "All salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered whether directly or through an agent and whether in cash or in property . . . ." 72 P.S. §§ 7303(a)(1)(i).[28] Qui tam payments are not explicitly listed in this definition. Thus, in order to ascertain whether these

---

[28] In addition to compensation, the other classes of income listed in Section 303 include net profits; net gains or income from disposition of property; net gains or income derived from or in the form of rents, royalties, patents and copyrights; dividends; interest "derived from obligations which are not statutorily free from State or local taxation under any other act of the General Assembly . . . or under the laws of the United States . . . ."; gambling and lottery winnings other than noncash prizes of the Pennsylvania State Lottery; and net gains or income derived through estates or trusts. 72 P.S. § 7303(a)(2)-(8).

payments constitute taxable compensation, we must determine whether they fall within any of the categories of compensation enumerated in Section 303(a)(1)(i).

To answer that question, an understanding of qui tam actions under the FCA is necessary. The FCA aims to prevent fraud upon the federal government by incentivizing private citizens, known as relators or whistleblowers, to act "for the person and for the United States Government" against the entity perpetrating fraud. 31 U.S.C. § 3730(b)(1). The action is brought in the name of the federal government. *Id.* Once the relator files suit and notifies the government, the government chooses whether to pursue the claim, to allow the relator to pursue the claim, or to seek dismissal of the claim. *Id.* § 3730(b)(2), (b)(4), (c). If the government declines to intervene, the relator has the exclusive right to conduct the action. *Id.* § 3730(b)(4). Whistleblowers, who, quite often are employed by the entity engaging in fraud, are authorized to receive a portion of the award ultimately obtained by the government in view of their role in bringing and pursuing the action. *Id.* § 3730(d). The payment is proportional to the whistleblower's efforts in the case, including the nature of the information that the whistleblower discloses to the federal government and the role the whistleblower played in advancing the case to litigation. *Id.*

The FCA "gives the relator an interest in the lawsuit, and not merely the right to retain a fee out of the recovery." *Vermont Agency of Nat. Res.*, 529 U.S. at 772 (emphasis removed). In addition to authorizing relators to act for themselves and the federal government, the FCA gives relators the right to continue as parties to the action, even where the government has assumed primary responsibility for prosecuting it, 31 U.S.C. § 3730(c)(1); entitles relators to a hearing if the government seeks dismissal of the claim,

id. § 3730(c)(2)(A); and prohibits the government from unilaterally settling claims over relators' objections without a specific judicial determination, *id.* § 3730(c)(2)(B).

Awarding the whistleblower a portion of the settlement allows the individual who initiated the qui tam lawsuit to share in the amount ultimately paid by the entity perpetrating the fraud, thereby providing these individuals with a financial incentive to turn on their employers. The purpose of the FCA is to "enhance the government's ability to recover losses sustained as a result of fraud against the government," and the qui tam provisions achieve incentives for "whistle-blowing insiders with genuinely valuable information." *In re Natural Gas Royalties*, 562 F.3d 1032, 1038-39 (10th Cir. 2009) (cleaned up). This incentive drives the initiation of the lawsuit, an economic reality the federal courts have recognized time and time again.[29]

---

29 *See, e.g., Campbell v. Redding Med. Ctr.*, 421 F.3d 817, 821 (9th Cir. 2005) ("Congress sought to provide incentives to qui tam whistleblowers to come forward. . . ."); *United States ex rel. Fine v. Sandia Corp.*, 70 F.3d 568, 571 (10th Cir. 1995) (observing that, to further the purpose of recovering losses sustained as a result of fraud, Congress sought to achieve "the golden mean between adequate incentives for whistle-blowing insiders with genuinely valuable information and discouragement of opportunistic plaintiffs who have no significant information to contribute of their own."); *United States v. Northrop Corp.*, 59 F.3d 953, 963 (9th Cir. 1995) (recognizing that that the central purpose of the qui tam provisions is to "set up incentives to supplement government enforcement" and "encourage insiders privy to a fraud on the government to blow the whistle on the crime"); *United States v. NEC Corp.*, 11 F.3d 136, 139 (11th Cir. 1993) ("The FCA's qui tam provisions do not act as a penalty; rather, they provide incentive to government 'whistleblowers' and compensate such individuals for their time and trouble."); *United States ex rel. Stinson, Lyons, Gerlin & Bustamante, v. Prudential Ins. Co.*, 944 F.2d 1149, 1154 (3d. Cir. 1991) (recognizing incentives for private enforcement of the FCA); *Rocco v. Comm'r of Internal Rev.*, 121 T.C. 160, 165 (T.C. 2003) ("The payment to a relator in a qui tam action is not a penalty imposed on the wrongdoer; instead, it is a financial incentive for a private person to provide information and prosecute claims relating to fraudulent activity."); *United States ex rel. Semtner v. Med. Consultants*, 170 F.R.D. 490, 495 (W.D. Okla. 1997) ("It is undeniable on even the most cursory review of the legislative record that the qui tam provisions were added to the FCA as an incentive to have individuals come forward with information and prosecute claims which might not be

Incentive payments are included in the statutory definition of compensation. 72 P.S. § 7303. Although "incentive payment" is not statutorily defined, an incentive is generally understood as something provided to motivate further action. Merriam-Webster defines "incentive" as "something that incites or has a tendency to incite to determination or action." *Incentive*, MERRIAM-WEBSTER'S ONLINE DICTIONARY, https://www.merriam-webster.com/dictionary/incentive (last visited Dec. 3, 2021). And the term "payment" plainly includes the provision of a portion of a financial settlement, such as the percentage of the settlement contemplated in the FCA.

By the terms of the FCA, O'Donnell's qui tam payment was intended to incentivize whistleblowers like O'Donnell to identify employer fraud, initiate the qui tam action, and provide valuable information to the federal government. To compensate O'Donnell for acting as a relator under the FCA, O'Donnell received 16% of the global settlement, an amount warranted because O'Donnell's "substantially contributed to the prosecution of the action." 31 U.S.C. § 3730(d)(1). The qui tam payment plainly was O'Donnell's incentive. This incentive payment is taxable as compensation under the plain language of the Tax Reform Code, and, therefore, as earned income under the LTEA. *See Marchlen v. Twp. of Mt. Lebanon*, 746 A.2d 566, 569 (Pa. 2000) (holding that stock options granted as an award and "incentive to promote the employer's well-being" are

---

initially efficient for the government to pursue."); *United States ex rel. Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645 (D.C. Cir. 1994) (recognizing that the 1986 amendments to the FCA enhanced incentives by increasing the monetary award to relator).

"incentive payments" under the LTEA). The plain language of the statute answers the question before us.[30]

Rather than apply the plain language of Section 303, the Commonwealth Court held that, in order for O'Donnell's whistleblower payment to be compensation, it would have to have been for services rendered, which, in turn, would require O'Donnell to be an employee of the federal government. *O'Donnell,* 880 C.D. 2019, 2020 WL 7413634 at *9. The Dissent likewise would conclude that Section 303's definition of compensation as imported into the LTEA reasonably suggests that an employment relationship is required. Dissenting Op. at 2.

There is nothing in the plain language of Section 303 suggesting that an employment nexus is a prerequisite for a payment to qualify as compensation. By omitting employment as a prerequisite, the statute plainly does not require it. *See Commonwealth v. Giulian*, 141 A.3d 1262, 1268 (Pa. 2016) ("[A]lthough one is admonished to listen attentively to what a statute says, one must also listen attentively to what a statute does not say.") (cleaned up). The plain language of Section 303 includes

---

30 While a qui tam payment is categorized most aptly as a taxable incentive payment, it also meets Section 303's definition of compensation for "similar remuneration for services rendered." 72 P.S. § 7303(a)(1)(i). The qui tam payment was rendered as remuneration for O'Donnell's services in providing useful information to the federal government about his employer's fraud and for initiating the qui tam action. *See* 31 U.S.C. § 3730 (d)(1) (tying the amount of the award to the level of contribution); *NEC Corp.*, 11 F.3d at 139 (11th Cir. 1993) ("The FCA"s qui tam provisions do not act as a penalty; rather, they provide incentive to government 'whistleblowers' and compensate such individuals for their time and trouble.").

"incentive payment" as compensation without regard to an employment relationship between the payor and payee.[31]

The Commonwealth Court's non-statutory creation of an employment requirement in Section 303 does not account for the enumerated categories of compensation contained in Section 303 that plainly do not pertain to employment at all. For example, commissions, fees, and tips routinely are provided outside of any employment relationship. As the Department of Revenue notes, contractors who submit 1099-MISC forms do so in order to report their non-employee compensation.[32] The Tax Reform Code generally recognizes non-employee compensation and requires withholding for such compensation. 72 P.S. § 7316.2. Non-employee compensation further includes real estate finder fees, referral fees, rewards for finding lost pets, and payments to artists and tradespersons.[33] There is no statutory basis for the Commonwealth Court's narrowing of taxable compensation in Pennsylvania.[34]

---

31 Finding ambiguity as to whether Section 303 requires compensation to be tied to an employment relationship, the Dissent would apply the maxim that ambiguity in tax statutes must be resolved in favor of the taxpayer to hold that the qui tam payment is not taxable as compensation. *See* Dissenting Op. at 2-4. The statute's omission of an employment prerequisite does not render the statute ambiguous. Rather, this omission reveals that the statute, by its plain terms, does not tie compensation to employment.

32 Department's *Amicus Curiae* Br. at 10.

33 Department's *Amicus Curiae* Br. at 11-12.

34 Our statutory interpretation is consistent with the Supreme Court of the United States' understanding of qui tam payments. In *Vermont Agency of Natural Resources,* 529 U.S. at 772, the High Court recognized that a relator has both "an interest in the lawsuit" and "a concrete private interest" in the outcome. The relator's interest in the lawsuit (including providing evidence, initiating the action, continuing as a party, being heard before dismissal, and objecting to the government's settlement), demonstrates the services provided by the relator. The qui tam payment vindicates the relator's private interest. This understanding demonstrates that the qui tam payment is an incentive payment and "remuneration for services rendered."

The Commonwealth Court's holding is premised upon a disregard of the statute's plain language in favor of what that court perceived to be a more limited regulatory definition of compensation. The Dissent likewise relies upon the regulation as a definition tying compensation to employment. Dissenting Op. at 3. As noted, the Department's regulation provides that "compensation"

> includes items of remuneration received . . . for services rendered as an employee or casual employee, agent or officer of an individual, partnership, business or nonprofit corporation, or government agency. These items include salaries, wages, commissions, bonuses, stock options, incentive payments, fees, tips, dismissal, termination or severance payments, early retirement incentive payments and other additional compensation contingent upon retirement, including payments in excess of the scheduled or customary salaries provided for those who are not terminating service, rewards, vacation and holiday pay, paid leaves of absence, payments for unused vacation or sick leave, tax assumed by the employer, or casual employer signing bonuses, amounts received under employee benefit plans and deferred compensation arrangements, and other remuneration received for services rendered.

61 Pa. Code § 101.6(a).

The regulation does not limit compensation to an employment relationship. Nor does the regulation define compensation. It merely offers a non-exclusive list of common examples of remuneration that the Department believes qualify as compensation. By repeatedly describing "compensation" to "include" various forms of payments, the regulation indicates its descriptive, non-exhaustive nature. *See Dechert LLT v. Commonwealth*, 998 A.2d 575, 581 (Pa. 2010) (providing that "include" is a word of enlargement and not limitation). This indication is reinforced by that last sentence of the regulation, providing a catch-all for compensation that mirrors Section 303 for "other remuneration received for services rendered." The regulation offers common examples of items that the Department believes qualify as compensation, rather than an exhaustive list.

Even assuming for argument's sake a conflict between the statute and the regulation, which there is not, courts cannot impose a regulatory requirement that is contrary to the plain statutory language. *See Commonwealth v. DiMeglio*, 122 A.2d 77, 80 (Pa. 1956) ("The power of an administrative agency to prescribe rules and regulations under a statute is not the power to make law, but only the power to adopt regulations to carry into effect the will of the Legislature as expressed by the statute."). Because the statute does not make the taxability of remuneration contingent upon the recipient's employment status, remuneration for services rendered need not arise in an employment or agency context.

The Dissent posits that a qui tam payment is not compensation because a relator's actions in connection with the qui tam lawsuit can reasonably be viewed as providing services to the relator himself, and not the federal government. Dissenting Op. at 2. The Dissent relies upon *Vermont Agency of Natural Resources* as support for its position that a relator's private interest in a qui tam action lends ambiguity to the Tax Reform Code's statutory requirement that compensation be in exchange for "services rendered." Dissenting Op. at 4-5. *Vermont Agency of Natural Resources* does not support the Dissent and, in fact, supports quite the opposite.

In *Vermont Agency of Natural Resources*, the Court examined whether a relator had standing under Article III of the United States Constitution to bring suit on behalf of the United States. 529 U.S. at 771-78. "Article III judicial power exists only to redress or otherwise to protect against injury to the complaining party." *Id.* at 771 (citing *Warth v. Seldin*, 422 U.S. 490, 499 (1975)). Article III standing requires a plaintiff to demonstrate "injury in fact"—"a harm that is both concrete and actual or imminent, not conjectural or

hypothetical." *Id.* at 771 (cleaned up). To determine whether the relator had standing under Article III, the High Court entertained and rejected two purported bases for standing before finding one that fit the circumstances and afforded such standing to the relator.

First, the Court examined whether the relator had standing as an agent of the federal government, and concluded that he did not. Although the relator brought the action in the government's name, and would receive a portion of the government's award, it was also true that "the statute gives the relator himself an interest *in the lawsuit*, and not merely the right to retain a fee out of the recovery." *Id.* at 772 (emphasis in original). Because the FCA afforded the relator a significant role in the proceedings of the lawsuit itself, distinct from the role of the government, the Court was unable to conclude that the relator was acting solely as the government's agent. *Id.* Were the relator simply acting as an agent of the federal government, there would be no Article III standing. *Id.* Because the relator was not acting solely as an agent, the Court continued looking for another basis for standing.

The Court then examined whether the relator had Article III standing based upon his own "injury in fact." Although the relator had a "concrete private interest" in the "bounty he will receive if the suit is successful," this interest was not an "injury in fact" for purposes of Article III standing because the payment was not compensation for the violation of the relator's legally protected right. *Id* at 772-73.

Having found no agency standing or injury in fact, the High Court ultimately found that the relator possessed representational standing under Article III: "The FCA can reasonably be regarded as effecting a partial assignment of the Government's damages

claim[,]" essentially conferring "representational standing" on the part of the assignee. *Id.* at 773.

Because the High Court recognized the relator's interest in the lawsuit and the outcome, the Dissent believes that *Vermont Agency of Natural Resources* supports its position that qui tam payments are not remuneration for services. According to the Dissent, because the relator is "principally serving himself," the relator is providing no service to the government. Dissenting Op. at 5.

Nothing in *Vermont Agency of Natural Resources* suggests that the relator's role in the litigation or interest in the award transforms the qui tam payment into something other than an incentive payment or remuneration for services rendered. Rather, the relator has both "an interest in the lawsuit" and "a concrete private interest" in the outcome. *Vermont Agency of Natural Resources*, 529 U.S. at 772-73. The relator's interest in the lawsuit (including providing evidence, initiating the action, continuing as a party, being heard before dismissal, and objecting to the government's settlement), demonstrates the services provided by the relator. The qui tam payment vindicates the relator's private interest. This understanding demonstrates that the qui tam payment is, contrary to the Dissent, an incentive payment and "remuneration for services rendered."

Moreover, *Vermont Agency of Natural Resources* recognized that a relator acts in two capacities: one serving the relator's own interest in the lawsuit, 529 U.S. at 772, and one representing the government through "a partial assignment of the Government's claim," *id.* at 773. Even if the Dissent were correct that a relator's private interest in the outcome of a qui tam action somehow meant that the relator could not receive remuneration for services rendered, this would not account for the distinct role that the

relator serves as the government's representative. As the government's representative, the relator is not "serving himself," Dissenting. Op. at 5, but is serving the government's distinct interest.

The Commonwealth Court opined that it would be "incongruous" to "encourage individuals to ferret out government waste" while nonetheless "punish[ing] them by taxing the proceeds for doing so." 2020 WL 7413634 at *10. Regardless of the Commonwealth Court's views concerning incentives and disincentives arising from the law of taxation, the judiciary is obligated to construe the plain terms of the statute. The federal government itself, which created qui tam payments in the FCA, has also chosen to tax such payments as gross income.[35] The federal government and the General Assembly are aligned in believing that taxing incentive payments is neither incongruous nor punitive.

We cannot ignore a statute's plain language in service of strictly construing tax statutes against the government. 1 Pa.C.S. § 1928(b)(3) (directing courts to construe strictly all provisions imposing taxes)); 1 Pa.C.S. § 1921(b) ("When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit."). There is no ambiguity or reasonable doubt that Section 303 defines compensation to include incentive payments, or that qui tam actions are incentive payments. We reverse the order of the Commonwealth Court.

Justices Saylor, Dougherty and Mundy join the opinion.

---

35 *See, e.g., United States ex rel. Kelly v. Boeing Co.*, 9 F.3d 743 (9th Cir. 1993); *Patrick v. Commissioner*, 142 T.C. No. 5 (2014); *United States ex rel. Green v. Northrop Corp.*, 59 F.3d 953 (9th Cir. 1995); *Campbell v. Commissioner*, 658 F.3d 1255 (11th Cir. 2011); *Bagley v. United States*, 963 F.Supp.2d 982 (C.D.Cal. 2013).

Justice Todd files a dissenting opinion in which Chief Justice Baer and Justice Donohue join.

COMMONWEALTH COURT OF PENNSYLVANIA

Kuharchik Construction, Inc., Petitioner v. Commonwealth of Pennsylvania, Respondent

No. 486 F.R. 2015

June 9, 2021, Submitted

October 14, 2021, Filed

October 14, 2021, Decided

Kuharchik Construction, Inc., Petitioner: John Alan Greenhall, Law Firm: Cohen Seglias Pallas Greenhall & Furman PC, Cohen Seglias Pallas ET AL, Philadelphia, PA; Roy S. Cohen, Cohen Seglias Pallas Greenhall & Furman PC, Cohen Seglias Pallas ET AL, Philadelphia, PA.

Kuharchik Construction, Inc., Petitioner: Ashling A. Ehrhardt, Cohen Seglias Pallas Greenhall & Furman, PC, Cohen Seglias Pallas Et Al, Philadelphia, PA; Sydney Elizabeth Harris Pierce, Cohen Seglias Pallas Greenhall & Furman PC, Philadelphia, PA.

Commonwealth of Pennsylvania, Respondent: Karen Marie Gard, Office of Attorney General, Harrisburg, PA; Anthony Ryan Bowers, Pennsylvania Department of Revenue, Harrisburg, PA.

BEFORE: HONORABLE P. KEVIN BROBSON, President Judge, HONORABLE RENÉE COHN JUBELIRER, Judge, HONORABLE PATRICIA A. McCULLOUGH, Judge, HONORABLE ANNE E. COVEY, Judge, HONORABLE MICHAEL H. WOJCIK, Judge, HONORABLE ELLEN CEISLER, Judge, HONORABLE J. ANDREW CROMPTON, Judge. OPINION BY JUDGE COHN JUBELIRER.

RENÉE COHN JUBELIRER

OPINION BY JUDGE COHN JUBELIRER

Before the Court *en banc* are Exceptions filed by the Commonwealth of Pennsylvania (Commonwealth) to a July 15, 2020 three-judge panel Opinion and Order affirming in part and reversing in part the order of the Board of Finance and Revenue (Board) that granted in part and denied in part Kuharchik Construction, Inc.'s (Petitioner) Petition for Review of the use taxes imposed against it. *Kuharchik Constr., Inc. v. Commonwealth*, **236 A.3d 122** (Pa. Cmwlth. 2020) (*Kuharchik I*). Specifically, we concluded that Petitioner's purchase and use of items that support a traffic signal—specifically, signal poles, mast arms, and pedestal bases (Traffic Signal Related Purchases)[1] —qualify as "building machinery and equipment" (BME) as defined by **Section 201 (pp) of the Tax Reform Code** of 1971 (Code), **72 P.S. § 7201** (pp) (**Section 201(pp)**).[2] The Commonwealth asserts that this Court erred because: our decision that the Traffic Signal Related Purchases constitute BME resulted from an improper statutory construction analysis that is inconsistent with prior precedent; the holding analyzed BME as an exception to use tax rather than an exclusion and thus improperly modified the Commonwealth's burden; the Court misconstrued and conflated the Commonwealth's arguments and discussions, as well as the relevant statutory language; and the opinion contained factual conclusions inconsistent with or contradictory to the parties' Joint Stipulations of Fact (Stipulation). After careful review, we overrule the Exceptions.

I. BACKGROUND

The underlying facts, as stipulated by the parties and set forth fully in *Kuharchik I* , need not be restated here. For the present analysis, it is sufficient to state that Petitioner is a Pennsylvania corporation engaged in the electrical construction contractor business that regularly contracts with the Commonwealth and its subdivisions. (Stipulation (Stip.) [*2] ¶¶ 13-14.) Pursuant to

construction contracts with the Commonwealth, Petitioner purchased and installed the Traffic Signal Related Purchases in connection with the installation of traffic signals. (*Id.* ¶ 15.) Petitioner did not pay sales tax or remit use tax in purchasing the Traffic Signal Related Purchases. (*Id.* ¶¶ 27-29.)

The Department of Revenue (Department) performed a sales and use tax audit of Petitioner's activities covering the period of January 1, 2011, through January 31, 2014. (*Id.* ¶ 4.) Based on the audit, the Department found that Petitioner had a use tax deficiency. (*Id.* ¶¶ 5, 19, 19(a), 19(b), Exhibits (Exs.) A, B.) The Department found that the Traffic Signal Related Purchases were taxable because they do not qualify as BME. Petitioner then filed a Petition for Reassessment with the Department's Board of Appeals (BOA), contesting the audit's finding as to the use tax deficiency. (*Id.* ¶ 6, Ex. C.) While the BOA abated the penalties associated with the use tax deficiency because Petitioner showed good faith and a lack of negligence, it denied any tax relief, finding that the Traffic Signal Related Purchases are not BME but, rather, fell within the "real estate structure" exception to the use tax, as found in **Section 201(qq)** of the Code. (*Id.* Ex. D.) However, given that Petitioner is a construction contractor, the BOA found that this exception is not available to Petitioner and concluded that the Traffic Signal Related Purchases are subject to the Commonwealth's use tax. (*Id.* Ex. D at 2.) Petitioner then filed a Petition for Review with the Board. (*Id.* ¶ 8, Ex. E.) The Board denied relief, agreeing with the BOA's conclusion that the Traffic Signal Related Purchases are not within the definition of BME. (*Id.* Ex. F at 7.)

Petitioner then petitioned this Court for review of that order, asserting that the Traffic Signal Related Purchases are exempt as BME because the items are included under the term "traffic signals," as defined in **Section 201(pp)** or, alternatively, that the items constitute a traffic control system, which also qualifies as BME. In response, the Commonwealth argued that the Traffic Signal Related Purchases do not fit the unambiguous definition of BME, since they do not meet the "two-part test" from *Kinsley Construction, Inc. v. Commonwealth*, **894 A.2d 832** (Pa. Cmwlth. 2006), but instead are "structural supports" under the "real estate structure" exception.

In *Kuharchik I* , this Court agreed with Petitioner that the term "traffic signals" in the definition of BME necessarily encompasses the Traffic Signal Related Purchases because those items are required to support a traffic signal head for purposes of controlling traffic. *Kuharchik I*, **236 A.3d at 132** . After engaging in a statutory construction analysis as to the meaning of the term "traffic signals," we determined that the common usage of the term is an object used to transmit information, such as a notice or warning, to control traffic. For supportive inferences to this meaning of the term, we looked to the sample traffic signal plan provided by Petitioner, (Stip. Ex. H at 64), and the Department of Transportation's (DOT) "Traffic Signal Design Handbook" (Handbook), [*3] (Stip. Ex. L). ***Id.* at 132-33** . We further rejected the Commonwealth's argument that the Traffic Signal Related Purchases cannot be BME because those items are "real estate structure" under **Section 201(qq)** . ***Id.* at 134** . Looking to **Section 201(qq)** , which explicitly includes both "structural supports" and "traffic control devices," we reasoned that the inclusion of traffic control related items in both the definition of BME and "real estate structure" indicates that these definitions overlap. ***Id.*** Finding no statutory language indicating that an item cannot be BME simply because that item may also fall within the definition of "real estate structure," and recognizing that the Legislature did not include the Traffic Signal Related Purchases in the exclusions from the definition of BME as it did "conduit," "receptacle," and "junction boxes," we concluded that the Traffic Signal Related Purchases were included in the commonly used meaning of "traffic signals." ***Id.* at 134-35** . Accordingly, we reversed with regard to the Traffic Signal Related Purchases but affirmed with respect to the remaining contested items.

II. EXCEPTIONS

The Commonwealth filed Exceptions pursuant to **Rule 1571(i) of the Pennsylvania Rules of Appellate Procedure , Pa.R.A.P. 1571(i)** , in which it asserts this Court erred by: (1) concluding that the Traffic Signal Related Purchases constitute BME through an improper statutory interpretation analysis; (2) allegedly treating BME as an exception rather than an exclusion to use tax and thus improperly modifying the holding in *Crawford Central School District v. Commonwealth*, **585 Pa. 131** , **888 A.2d 616** (Pa. 2005); (3) misconstruing the Commonwealth's argument with regard to "support structures" and conflating statutory terms; and (4) making certain factual conclusions that were inconsistent with, unsupported by, or contradictory to the Stipulation.[3] We address these Exceptions in turn.

A. Whether this Court erred in determining that the Traffic Signal Related Purchases constitute BME and in our statutory interpretation analysis in so concluding.

1. Parties' Arguments

The Commonwealth takes exception to this Court's legal determination that the term "traffic signals" in the definition of BME encompasses "'poles, mast arms, and pedestal bases,' 'conduit receptacle, and junction boxes,' or other items 'required to support a traffic signal head for purposes of controlling traffic.'" (Exceptions ¶ 1 (quoting *Kuharchik I*, **236 A.3d at 132**).) First, the Commonwealth takes exception to this Court's statutory construction analysis in *Kuharchik I* . (Exceptions ¶ 2.) The Commonwealth argues that this Court erred by employing "a three-step process", in which we: (1) "spliced together Merriam-Webster's definitions of the terms 'traffic signal' and 'signal'"; (2) "syllogized that judicially-spliced definition with [the] separately undefined term . . . 'signal head' to expand that judicially-spliced definition as encompassing other 'related items' which are 'functionally required'"; and (3) "re-engrafted" the relevant statutory language onto our "syllogized-spliced definition as a post hoc exception" to arrive at the conclusion [*4] that the term "traffic signals" encompasses the Traffic Signal Related Purchases. (Commonwealth's Brief (Br.) at 4.) Additionally, the Commonwealth asserts that it was error to consider DOT's Handbook as an aspect of our statutory construction analysis. (Exceptions ¶ 2(a).)

The Commonwealth also contends that the Court failed to consider the factors and presumptions of the Statutory Construction Act of 1972 (Statutory Construction Act), 1 Pa.C.S. §§ 1501-1991 . (Exceptions ¶ 2(e).) Further, the Commonwealth asserts that "the BME definition is unambiguous" and that this Court "could have simply denied Petitioner's [P]etition on that basis." (Commonwealth's Br. at 19.) Because we found the term "traffic signals" to be ambiguous, the Commonwealth argues, this Court erred in not considering the requisite factors and presumptions under the Statutory Construction Act. (*Id.* (citing **1 Pa.C.S. §§ 1921-1922**).) Specifically, the Commonwealth contends that the Court failed to consider legislative intent, in that our "interpretation does not advance th[e] legislative goals of certainty and clarity[.]" (Commonwealth's Br. at 21.) Finally, because this Court ignored these factors and presumptions, the Commonwealth avers that our statutory interpretation analysis is inconsistent with that in *East Coast Vapor, LLC v. Pennsylvania Department of Revenue*, **189 A.3d 504** (Pa. Cmwlth. 2018); *Green Acres Contracting Co., Inc. v. Commonwealth*, **163 A.3d 1147** (Pa. Cmwlth. 2017); *Strongstown B&K Enterprises, Inc. v. Commonwealth*, **152 A.3d 360** (Pa. Cmwlth. 2016), *aff'd*, **642 Pa. 690 , 171 A.3d 252** (Pa. 2017); and *Kinsley Construction, Inc.*, **894 A.2d 832** . (Exceptions ¶ 4; Commonwealth's Br. at 13-14, 16-17.)

In response, Petitioner argues that the Court in *Kuharchik I* properly interpreted the statute and that "[t]he Commonwealth's exceptions merely disagree with the [Court's] interpretation of the statute, but offer no reason that [*Kuharchik I*] should be overturned." (Petitioner's Br. at 2.) To the extent that the Commonwealth argues that *Kuharchik I* is inconsistent with other precedential authority, Petitioner asserts that these cases "were either already addressed in a detailed fashion by the [Court in *Kuharchik I*], or are so distinguishable that they would not have been instructive[.]" (*Id.* at 3.) Because we addressed the crux of the Commonwealth's arguments in *Kuharchik I* , Petitioner argues the Exceptions should be denied. (*Id.* at 4-5 (citing *Greenwood Gaming & Ent., Inc. v. Commonwealth*, **218 A.3d 982 , 988** (Pa. Cmwlth. 2019); *Solar Turbines Inc. v. Commonwealth*, **841 A.2d 626 , 628** (Pa. Cmwlth. 2004)).) Moreover, Petitioner argues that, despite the Commonwealth's many Exceptions to our legal conclusions and statutory analysis, it does not offer any alternative analysis in which this Court should have engaged or any argument as to why the Traffic Signal Related Purchases should not be considered a part of a "traffic signal" apparatus. (*Id.* at 8.) Petitioner further asserts that this Court did not determine that the term "traffic signals" was ambiguous; "rather, it simply proceeded to interpret the term according to its 'common usage,' given the absence of a statutory definition." (*Id.* at 18-19 (quoting *Kuharchik I*, **236 A.3d at 131-32**).) Thus, Petitioner maintains that our statutory construction was proper and that [*5] this Court should deny the Exceptions.

In its Reply Brief, the Commonwealth argues that the Court did not apply the plain meaning of the term "traffic signal" and that the term is ambiguous. (Commonwealth's Reply Br. at 2-4.) Even if unambiguous, the Commonwealth maintains that the Court failed to interpret the term properly under **Section 1903(a) of the Statutory Construction Act , 1 Pa.C.S. § 1903(a)** , because we did not specifically analyze the term as a technical or nontechnical phrase. (*Id.* at 6.) Regardless of whether the Court interpreted the term as a technical or nontechnical phrase, the Commonwealth argues that the Court either did not apply "the peculiar and appropriate meaning of a technical term," or that the meaning the Court deduced was not a "common and approved usage" of the term. (*Id.* at 7-8.) Further, by looking to only one dictionary definition, the Commonwealth asserts that we "essentially suggested Merriam-Webster to be the *exclusive* referee for determining the 'common and approved usage' of a term." (*Id.* at 8-9 n.6 (emphasis in original).) The Commonwealth finally clarifies that it does not take exception to the mere "splicing" two terms together but with the Court's "[s]yllogizing the judicially[-]spliced definition" against the term "signal head" and then "[e]ngrafting separate statutory language as a post-hoc exception to its syllogized-spliced definition." (*Id.* at 10 n.8 & n.9.)

2. Analysis

As we said in *Kuharchik I* , this Court's statutory interpretation is guided by the Statutory Construction Act. "The object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly." **Section 1921(a) of the Statutory Construction Act , 1 Pa.C.S. § 1921(a)** . "The clearest indication of legislative intent is generally the plain language of a statute." *Walker v. Eleby*, **577 Pa. 104 , 842 A.2d 389 , 400** (Pa. 2004). "When the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit." **1 Pa.C.S. § 1921(b)** . However, we employ statutory construction "[w]hen the words of the statute are not explicit[.]" **1 Pa.C.S. § 1921(c)** . In doing so, the general rule is that "[w]ords and phrases shall be construed . . . according to their common and approved usage[,]" and " [e]very statute [is to] be construed, if possible, to give effect to all its provisions" to assure "that no provision is reduced to mere surplusage." **Sections 1903(a)** and **1921(a) of the Statutory Construction Act , 1 Pa.C.S. §§ 1903(a) , 1921(a)** ; *Walker*, **842 A.2d at 400** . It is well settled that "[w]here a court needs to define an undefined term, it may consult definitions in statutes, regulations[,] or the dictionary for guidance, although such definitions are not controlling." *Adams Outdoor Advert., LP v. Zoning Hearing Bd. of Smithfield Twp.*, **909 A.2d 469 , 484** (Pa. Cmwlth. 2006).

We first look to the provisions of the statute that are at issue. **Section 201(pp)** defines BME, in relevant part, as follows:

> **"Building machinery and equipment."** Generation equipment, storage equipment, conditioning equipment, distribution equipment and termination equipment, which shall be limited to the following:
>
> . . . .
>
> (6) **control system** limited to energy management, **traffic** and parking lot and building access;
>
> . . . .

> The term [*6] **shall include** boilers, chillers, air cleaners, humidifiers, fans, switchgear, pumps, telephones, speakers, horns, motion detectors, dampers, actuators, grills, registers, **traffic signals**, sensors, card access devices, guardrails, medical devices, floor troughs and grates and laundry equipment, together with integral coverings and enclosures, whether or not the item constitutes a fixture or is otherwise affixed to the real estate, whether or not damage would be done to the item or its surroundings upon removal or whether or not the item is physically located within a real estate structure. The term "[BME]" shall not include guardrail posts, pipes, fittings, pipe supports and hangers, valves, underground tanks, wire, conduit, receptacle and junction boxes, insulation, ductwork and coverings thereof.

72 P.S. § 7201(pp) (first emphasis in original). **Section 201(qq)** defines "real estate structure," in relevant part, as follows:

> **"Real estate structure."** A structure or item purchased by a construction contractor pursuant to a construction contract with:
>
> . . . .
>
> (3) the Commonwealth, its instrumentalities or political subdivisions.
>
> The term includes [**BME**]; developed or undeveloped land; streets; roads; highways; parking lots; stadiums and stadium seating; recreational courts; sidewalks; foundations; **structural supports**; walls; floors; ceilings; roofs; doors; canopies; millwork; elevators; windows and external window coverings; outdoor advertising boards or signs; airport runways; bridges; dams; dikes; **traffic control devices**, including traffic signs; satellite dishes; antennas; guardrail posts; pipes; fittings; pipe supports and hangers; valves; underground tanks; wire; conduit; receptacle and junction boxes; insulation; ductwork and coverings thereof; and any structure or item similar to any of the foregoing, whether or not the structure or item constitutes a fixture or is affixed to the real estate, or whether or not damage would be done to the structure or item or its surroundings upon removal.

72 P.S. § 7201(qq) (first emphasis in original). Construction contractors are required to pay a use tax for the purchase or use of "real estate structure." **Section 32.23(b)** of the Department's Regulations, **61 Pa. Code § 32.23(b)** . However, construction contractors are not required to pay a use tax for BME that is transferred to the Commonwealth or its political subdivisions. **Section 204 (57)(ii)** of the Code, **72 P.S. § 7204** (57)(ii) (**Section 204(57)**).

In determining that the Traffic Signal Related Purchases were within the meaning of "traffic signals" in *Kuharchik I* , we explained:

> The Code does not define the term "traffic signals." In the absence of a definition, pursuant to the rules of statutory construction, we construe the term "traffic signals" according to its common usage. **1 Pa.C.S. § 1903(a)** . "[T]raffic signal" is defined as "**a signal** (such as a **traffic light**) for **controlling traffic**." *Traffic Signal*, Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/traffic%20 signal (last visited July 14, 2020) (emphasis added). "Signal" is defined as "something (such as a sound, gesture, or object) that **conveys notice or warning**" or "**an object used to transmit** or convey **information** [*7] **beyond the range of human voice**." *Signal*, Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/signal (last visited July 14, 2020) (emphasis added). Thus, a traffic signal is an object used to transmit information, such as a notice or warning, to control traffic.
>
> The sample traffic signal plan provided by Petitioner shows two traffic signal heads connected to a mast arm, which is connected to a traffic signal pole, which in turn is anchored with a pedestal base. (Stip. Ex. H at 64.) Based upon the sample [traffic signal] plan, it is clear that the Traffic Signal Related Purchases are required to elevate a traffic signal head above traffic when a traffic signal apparatus is built pursuant to this plan because, without the Traffic Signal Related Purchases, the traffic signal head could not operate to control traffic. Therefore, because a traffic signal head, containing the green, yellow, and red lights, by itself cannot transmit signals to control traffic without it being elevated over or near a roadway, more than merely the traffic signal head constitutes the "traffic signal." *See Traffic Signal*, Merriam-Webster Dictionary, https://www.merriam-webster.com/dictionary/traffic%20signal (last visited July 14, 2020). Accordingly, poles, mast arms, and pedestal bases, in this case the Traffic Signal Related Purchases, are encompassed within the term "traffic signals," when a traffic signal is built using a pole with mast arms because those items are required to support a traffic signal head for purposes of controlling traffic.

Kuharchik I, **236 A.3d at 132** (emphasis in original). Given this determination as to the commonly used meaning of "traffic signals," we rejected the Commonwealth's argument that Petitioner was required "to classify the Traffic Signal Related Purchases into one of the five categories of equipment constituting BME[.]" ***Id.* at 133** . Rather, we explained that

> the Traffic Signal Related Purchases are included within the term "traffic signals," which is specifically included within the definition of BME. Thus, it is not necessary for Petitioner to first establish the Traffic Signal Related Purchases fall into one of the five categories of equipment included within BME because "traffic signals" are specifically included in the definition of BME.

Id.

We do not find the Commonwealth's argument persuasive with respect to any alleged error in our employing an analysis that looks to the independent, common usages of the words that comprise a term at issue in order to determine the meaning of the term as a whole and then considers that meaning in light of other relevant evidence. While the Commonwealth asserts in its Reply Brief that it is not challenging the "splicing" of the definitions of "traffic signal" and "signal" together, (Commonwealth's Reply Br. at 10), its argument in its principal Brief suggests otherwise. Our Supreme Court engaged in a similar statutory interpretation analysis in *A Special Touch v. Department of Labor and Industry, Office of Unemployment Compensation Tax Services*, **228 A.3d 489** , **503** (Pa. 2020). There, the Supreme Court analyzed [*8] the term "customarily engaged" as it is used in Subsection 4(*l*) (2)(B) of the Unemployment Compensation Law, **43 P.S. § 753** (*l*)(2)(B).[4] The Supreme Court looked to the individual dictionary definitions of "customarily" and "engage," determining the words, respectively, to mean "usually, habitually, according to the customs; general practice or usual order of things; regularly" and "[t]o employ or involve one's self; to take part in; to embark on." *A Special Touch*, **228 A.3d at 503** (quoting Black's Law Dictionary 385, 528 (6th ed. 1990)). With the individual definitions of these words in mind, the Court then determined that the phrase "'customarily engaged' requires an individual to be 'usually,' 'habitually,' or 'regularly' 'employed' or 'involved' in activity; or 'employed' or 'involved' in activity 'according to the customs,' 'general practice,' or 'usual order of things.'" ***Id.***

Thus, this type of statutory construction analysis is not uncommon or improper. As Petitioner argues, this Court's analysis complied with the rules of statutory construction by construing the term "traffic signal" "according to [its] common and approved usage[.]" **1 Pa.C.S. §§ 1903(a)** , **1921(a)** ; *Walker*, **842 A.2d at 400** , because "the words of the statute are not explicit" in defining that term, **1 Pa.C.S. § 1921(c)** .

However, the Commonwealth also asserts that the Court erred by then expanding the definition of "traffic signals" to include other undefined terms such as a signal head and other related items that are functionally required and "re-engraft[ing]" other statutory language onto that definition. (Commonwealth's Br. at 4.) For clarification, the Court's statutory construction analysis as to the meaning of "traffic signals" culminated with our determination that "a traffic signal is an object used to transmit information, such as a notice or warning, to control traffic." *Kuharchik I*, **236 A.3d at 132** . We then considered that definition in light of other evidence of record, specifically, the sample traffic signal plan and the DOT's Handbook provided by the parties as part of the Stipulation. These support our conclusion that the Traffic Signal Related Purchases function together as a traffic signal under the above definition, because the sample traffic signal plan showed the Traffic Signal Related Purchases were necessary for the traffic signal, including the traffic signal head, to "transmit information . . . to control traffic." ***Id.*** We discern no error with this analysis. Further, the Commonwealth has provided no authority for its contention that it was improper to consider the sample traffic signal plan or the DOT's Handbook as supporting the meaning of "traffic signal."

In addition, as it pertains to our statutory construction analysis, the Commonwealth asserts that the BME definition is unambiguous and that our analysis was in error because we failed to state whether we were interpreting a nontechnical term or a technical term under **Section 1903(a) of the Statutory Construction Act** . Alternatively, if the Court determined that the term is ambiguous, the Commonwealth argues that the Court failed to apply the requisite factors and presumptions to interpret ambiguous terms and consider legislative [*9] intent in determining its meaning. Under either approach, the Commonwealth maintains that our definition was in error . We disagree.

The Supreme Court recently addressed a similar situation in *United Blower, Inc. v. Lycoming County Water and Sewer Authority*, __ **A.3d** __, __, **[2021 BL 358841]**, 2021 Pa. LEXIS 3621 (Pa., No. 3 MAP 2021, filed September 22, 2021). There, the Supreme Court examined the term "cost" as provided in the definition of "steel products" in **Section 6 of the Steel Products Procurement Act** (Steel Act)[5] **73 P.S. § 1886** . Applying the rules of statutory construction, the Court explained that while "[t]he Steel Act offers no definition of the word 'cost,' . . . it is a word with a 'common and approved usage.'" **[2021 BL 358841]**, 2021 Pa. LEXIS 3621 , *17 . Rejecting arguments that the term "cost" was a term with technical or peculiar meaning, the Court explained that such arguments did "not render the word ambiguous." ***Id.*** As such, the Court construed the term in accordance with its common and approved usage and looked to dictionary definitions of the term. This is precisely what this Court did in *Kuharchik I* . As Petitioner argues, we did not opine as to whether the term was ambiguous, as it was not necessary in order to determine the term's meaning. Rather, because **Section 201(pp)** did not define "traffic signals," we construed the term "according to [its] common and approved usage[.]" **1 Pa.C.S. § 1903(a)** . Accordingly, we discern no basis for finding that this Court's analysis failed to comply with the rules of statutory construction.

The Commonwealth also argues that our analysis was inconsistent with prior precedent, specifically *East Coast Vapor*, **189 A.3d at 504** ; *Green Acres*, **163 A.3d at 1147** ; *Strongstown*, **152 A.3d at 360** ; and *Kinsley Construction*, **894 A.2d at 832** . (Exceptions ¶ 4; Commonwealth's Br. at 16-17.) The Commonwealth raised similar arguments in *Kuharchik I* , also citing *Green Acres*, *Kinsley Construction*, and *Strongstown* .

In *Kuharchik I* , we discussed these cases in turn as follows:

> [I]n *Green Acres* , this Court was presented with a similar issue where we were required to interpret the scope of an undefined term included within the definition of BME.
>
> Specifically, in *Green Acres* , we examined "the scope of the term 'guardrails' as used in the definition of tax exempt" BME. **163 A.3d at 1148** . The taxpayer in *Green Acres* argued "that the term 'guardrails,'" as used in the definition of BME, "refers to the entire guardrail system, with the exception of guardrail posts, which are specifically excluded." ***Id.*** As such, the taxpayer concluded, the "nuts, bolts, washers, and guardrail blocks, which are necessary for the

construction of the guardrails, constitute tax exempt BME." ***Id.*** We agreed, concluding that the term "guardrails" includes "the nuts, bolts, washers, and guardrail blocks . . . utilized to connect the elements of the guardrail system." ***Id.* at 1152** . Noting that federal and state transportation publications use the term "guardrail" to refer to more than just the railing itself, we reasoned that the dictionary definition and common usage of the term "guardrails" "includes the entire guardrail system." ***Id.* at 1151** (emphasis omitted). We further reasoned that the fact "[t]hat only the 'guardrail posts' are carved out as taxable explains the Legislature's decision" not to specifically **[*10]** list the tax status of all of the components of a guardrail system. ***Id.* at 1152** . Accordingly, we concluded that since the definition of BME only excluded guardrail posts, the other components of a guardrail system "fall within the definition of 'guardrails,' and are therefore exempt from use tax as BME." ***Id.***

The Commonwealth contends that *Green Acres* is distinguishable from the present matter because none of the Traffic Signal Related Purchases are included in the per se list of items included within the definition of BME. Instead, the Commonwealth contends this case is similar to *Kinsley Construction* . However, *Kinsley Construction* is distinguishable from the present case. In *Kinsley Construction* , we examined, among other things, whether sound barriers and I-beams constitute BME. We concluded that sound barriers and I-beams are not BME, reasoning that "had the [L]egislature intended sound barriers," which includes I-beams that hold the sound barriers in place, "to be considered [BME], [it] would have [] included [these items] in the lengthy definition" of BME. *Kinsley Constr* [.], **894 A.2d at 836** . After *Kinsley Construction* , we decided *Strongstown* . . . , **152 A.3d [at] 360** []. In that case we examined, among other things, whether traffic signs were included within the definition of BME. Citing *Kinsley Construction* , we concluded that traffic signs did not constitute BME, reasoning that "the Legislature did not specifically list 'traffic signs' as they did 'traffic signals.'" *Strongstown* . . ., **152 A.3d at 368** . Unlike in *Kinsley Construction* and *Strongstown* . . . , the question here is not whether the Traffic Signal Related Purchases are expressly included within the Code's definition of BME but whether the term "traffic signals," which **is** expressly included within the definition of BME, encompasses the Traffic Signal Related Purchases. Therefore, the present matter is similar to *Green Acres* in that we must interpret the scope of an undefined term specifically listed in the per se list of items that are BME.

Kuharchik I, **236 A.3d at 133-34** (emphasis in original). After reviewing our analysis and those in *Green Acres, Kinsley Construction,* and *Strongstown* , we discern no error or inconsistency that would require reversal. Indeed, just as we determined that the nuts, bolts, washers, and guardrail blocks were comprised within the definition of "guardrails" after determining the common usage of that undefined term in *Green Acres*, **163 A.3d at 1152** , we determined in *Kuharchik I* that the Traffic Signal Related Purchases are within the commonly used meaning of "traffic signals." This is distinguishable from our analysis in *Strongstown* , though we did there engage in a similar statutory construction analysis in determining the meaning of the word "system" as it pertains to a "control system" for traffic. However, we determined in *Strongstown* that the record did not provide any support that road signs fell under that meaning. *Strongstown*, **152 A.3d at 368** . Conversely, we concluded in *Kuharchik I* that the record did support that the Traffic Signal Related Purchases were within the meaning of "traffic signals" considering its common usage and the sample **[*11]** traffic signal plan and the DOT's Handbook. Such an analysis is even more distinguishable from that in *Kinsley Construction* , as we did not there need to engage in any statutory construction analysis to determine the common usage of an undefined term; rather, because sound barriers and I-beams did not fall under **any** of the enumerated inclusions to the BME definition, we concluded that the items were not BME. *Kinsley Construction*, **894 A.2d at 836** . Accordingly, *Kuharchik I* is not inconsistent with these cases.

The Commonwealth also argues that our analysis in *Kuharchik I* employed an approach similar to one we rejected in *East Coast Vapor*. We disagree. In *East Coast Vapor*, the Department contended that the component parts, including replacement coils, regulated mods, and tanks, that are packaged and sold separately from the electronic cigarettes at issue, were "integral" parts that should be considered to be comprised in the statutory definition of "electronic cigarettes," **189 A.3d at 517-18** . The statute at issue defined "electronic cigarette" as:

> (1) An electronic oral device, such as one composed of a heating element and battery or electronic circuit, or both, which provides a vapor of nicotine or any other substance and the use or inhalation of which simulates smoking.
>
> (2) The term includes:
>
> > (i) A device as described in **paragraph (1)** , notwithstanding whether the device is manufactured, distributed, marketed or sold as an e-cigarette, e-cigar and e-pipe or under any other product, name or description.
> >
> > (ii) A liquid or substance placed in or sold for use in an electronic cigarette.

Section 1201-A of the Tobacco Products Tax Act , **72 P.S. § 8201-A** .[6] In that case, the Court examined the taxability of items that were not purchased with the taxable item, were not physically connected to the taxable item, and were not inherently part of the statutory definition of the taxable item.

On the other hand, this Court in *Kuharchik I* considered the taxability of the Traffic Signal Related Purchases, items that were purchased with the taxable item, the traffic signal head, and were physically connected to the traffic signal head. In *Kuharchik I* , rather than considering whether the Traffic Signal Related Purchases were "integral" to a "traffic signal," we engaged in a

statutory construction analysis to determine the ordinary meaning of the term "traffic signal" because the Code does not provide a definition. Accordingly, we disagree with the Commonwealth that *Kuharchik I* is inconsistent with *East Coast Vapor*.

Finally, we address the Commonwealth's assertion that *Kuharchik I* determined that the term "traffic signals" included "conduit, receptacle, and junction boxes[.]" (Exceptions ¶ 1.) After explaining our interpretation as to the common usage of "traffic signals" and determining that the Traffic Signal Related Purchases fell within that definition "because those items are required to support a traffic signal head for the purposes of controlling traffic[,]" we stated: "With that being said, any conduit, receptacle, and junction boxes, which **may be included within the term traffic signal, are subject** [*12] **to the Commonwealth's use tax because these items are specifically excluded from the definition of BME.**" *Kuharchik I*, **236 A.3d at 132-33** (emphasis added). Accordingly, we disagree with the Commonwealth that *Kuharchik I* determined that the meaning of "traffic signals" comprised these items.

In sum, the Commonwealth has not shown any basis for overturning *Kuharchik I* on the basis of any allegedly improper statutory construction analysis or that analysis being inconsistent with this Court's precedent, and we deny these Exceptions.

B. Whether this Court treated BME as exclusions rather than exemptions to the use tax and our required exclusivity between the Code's definitions.

1. Parties' Arguments

The Commonwealth argues that *Kuharchik I* "improperly modified the holding of *Crawford* . . . to essentially convert the BME exemption into an exclusion." (Commonwealth's Br. at 15; Exceptions ¶¶ 3, 7.) By "shifting the burden of proof from [Petitioner] (to prove an item qualified under the exemption) to the Commonwealth (to prove an item was excluded from the exemption) [,]" the Commonwealth alleges, this Court erred by not strictly construing the BME definition against the taxpayer. (Commonwealth's Br. at 16.) Further, the Commonwealth also argues that this Court erred in allegedly concluding that the Code "must explicitly indicate two separately defined terms are mutually exclusive" and our alleged shifting of the burden of the proof to require the Commonwealth to demonstrate exclusivity. (Exceptions ¶¶ 2(c), 2(d).) The Commonwealth asserts that this Court was led astray by Petitioner's argument and "wordplay" with regard to the relevant statutory language, which the Commonwealth asserts led to our "erroneous conclusion" that exclusivity is required and that the BME definition must explicitly exclude certain items in order for them to qualify for the exemption. (Commonwealth's Br. at 7-8, 10-12.)

In response, Petitioner asserts that, rather than shifting the burden of proof, this Court "did not force the Commonwealth to prove the [Traffic Signal Related] Purchases were taxable—[the Court] merely interpreted the statute as it is obligated to and determined that [Petitioner] had satisfied its burden of showing that the [Traffic Signal Related] Purchases are subject to an exemption." (Petitioner's Br. at 17.) Petitioner maintains that "construing a statute against the taxpayer does not necessarily mean that the taxpayer's interpretation must always fail." (*Id.*) For these reasons, Petitioners submit that the Court did not improperly shift any burden to the Commonwealth.

In its Reply Brief, the Commonwealth reasserts that the Court "erred by requiring the Commonwealth to prove the [Traffic Signal Related Purchases] were not *exempt*." (Commonwealth's Reply Br. at 11 (emphasis in original).)

2. Analysis

First, we address the Commonwealth's argument regarding our allegedly improper burden shifting. The Commonwealth argues that our opinion modified the holding in *Crawford*, **888 A.2d at 620** , by shifting the burden to the Commonwealth to show that an item is taxable. We disagree.

In *Crawford* , this Court **[*13]** recognized that the sales and use tax exemption for construction contractors is limited to BME as set forth in **Section 204(57)** , explaining that statutory provisions that excuse the taxation of items that are normally within the subject of taxation create exemptions that "must be strictly construed against the taxpayer." **888 A.2d at 621** . However, we differentiated between an exclusion and an exemption more thoroughly in *Plum Borough School District v. Commonwealth*, **860 A.2d 1155** (Pa. Cmwlth. 2004). There, we explained:

> that the title of **Section 204** denominates its contents as "exclusions from tax" and not "exemptions from tax."
>
> Exemptions are items which are **within the scope of the general language of the statute imposing the tax,** which were not intended to be taxed in the first place." *Rossi v. Commonwealth* . . ., **20 Pa. Commw. 517** , **342 A.2d 119** , **122** (Pa. Cmwlth. 1975). The legal effect of that distinction is that **exemptions are to be strictly construed against the taxpayer**; exclusions are to be construed against the taxing body. *Equitable Gas Co. v. Commonwealth* . . ., **18 Pa. Commw. 418** , **335 A.2d 892** (Pa. Cmwlth. 1975). However, "[w]hether a taxing provision is an 'exemption' . . or an 'exclusion' . . . is not controlled by what it is called, but by its language and the effect of that language." *Adelphia House P* ['] *ship v. Commonwealth* . . ., **709 A.2d 967** , **970** (Pa. Cmwlth. 1998).

Id.* at 1157 n.4** (emphasis added) (third and fourth alterations in original). Thus, a provision is properly analyzed as an exemption where the Court determines, while strictly construing the provision against the taxpayer, that the item at issue is "within the scope of the general language of the statute imposing the tax[.]" ***Id.

In *Kuharchik I* , we acknowledged that we were required to "be mindful that tax **exemptions are to be strictly construed against taxpayer**, and that the burden is on the taxpayer to prove that the transaction sought to be taxed is either not within the Code or is subject to an exemption[.]" *Kuharchik I*, **236 A.3d at 132** (emphasis in original) (internal quotations and citations omitted). We then engaged in the statutory construction analysis discussed above, concluding that Petitioner met its burden in showing that the Traffic Signal Related Purchases fell "within the scope of the general language" of the term "traffic signals" in the BME definition. *Plum Borough*, **860 A.2d at 1157 n.4** . Thus, we did not improperly shift the burden to the Commonwealth but, rather, applied the law to determine that the Traffic Signal Related Purchases were subject to the BME exemption and, therefore, that Petitioner had met its burden. Accordingly, we disagree with the Commonwealth that *Kuharchik I* shifted the burden to it or that we modified the holding in *Crawford* .

Next, we address the Commonwealth's argument that *Kuharchik I* required exclusivity between the Code's definitions of BME and "real estate structure." In our opinion, we stated:

> [T]he Code defines "real estate structure" to include BME, evidencing that an item that is BME can also be considered "real estate structure." ***Id.*** Additionally, the Code defines "real estate structure" to include "traffic control devices." ***Id.*** Seeing **[*14]** that traffic control items are used in both the definitions of BME and "real estate structure," it is clear the definitions of BME and "real estate structure" overlap. Further, while the Traffic Signal Related Purchases are support structures in the sense that they support and elevate the traffic signal head, the Traffic Signal Related Purchases, for the foregoing reasons, are included within the term "traffic signal," which is specifically included with the definition of BME. Absent any statutory language indicating that the Traffic Signal Related Purchases cannot be BME simply because they may also fall within the definition "real estate structure," we cannot conclude the Traffic Signal Related Purchases cannot be included in the term "traffic signals."
>
> Additionally, the definition of BME does not specifically exclude the Traffic Signal Related Purchases. If the Legislature did not intend the Traffic Signal Related Purchases to be included within the term "traffic signals," or more importantly within the definition of BME, the Legislature could have included the Traffic Signal Related Purchases in the list of items specifically excluded from the definition of BME as it did conduit, receptacle, and junction boxes.

Kuharchik I, **236 A.3d at 135** .

After review, we disagree that our holding in *Kuharchik I* required the BME definition to specifically exclude certain items in order for such purchases to not constitute BME or required mutual exclusivity between the Code's definitions. Rather, we concluded that Petitioner's burden to show that the Traffic Signal Related Purchases constitute BME had been met given our determination that the items fell within the commonly used meaning of "traffic signals." We then considered the fact that the Legislature provided for some overlap between the BME and real estate structure definitions and that the Legislature did not specifically exclude the Traffic Signal Related Purchases from the BME definition as factors that support our conclusion. Because we discern no error from this analysis, we will deny these Exceptions.

C. Whether the Court misconstrued the Commonwealth's arguments and discussions and conflated statutory language.

1. Parties' Arguments

The Commonwealth argues that this Court misunderstood and conflated its arguments and the relevant statutory terms in arriving at our allegedly erroneous conclusion that "traffic signals" included the Traffic Signal Related Purchases. First, the Commonwealth contends that the Court "altered the Commonwealth's argument into a generalized argument about 'support structures' rather than the specific argument which analyzed the statutory language." (Commonwealth's Br. at 5-7; Exceptions ¶ 9.) Because we stated in *Kuharchik I* that the Commonwealth's argument was "that the Traffic Signal Related Purchases are 'support structures'" rather than "structural supports," as listed in the "real estate structure" definition under **Section 201(qq)** , the Commonwealth asserts that the "decision was inconsistent with the statute, **[*15]** incorrect[,] and should be reversed." (Commonwealth's Br. at 5-7.) Further, the Commonwealth avers that our decision "was infected by [Petitioner's] wordplay[]" and evidenced that the Court misconstrued and conflated the terms "traffic signal," "traffic signal head," "traffic control system," "traffic control devices," "traffic control items," "traffic related purchases," and "control systems for traffic." (*Id.* at 8-9; Exceptions ¶ 2(b).) Moreover, the Commonwealth contends that the Court misunderstood its arguments as it pertains to the statutory "real estate structure" definition. (Exceptions ¶¶ 6, 8.) This use of conflated language, the Commonwealth argues, shows that the Court "misconstrued the Commonwealth's argument[,]" which "was not so untethered or imprecise[,]" and "thus unknowingly disregarded the *verbatim* statutory language[.]" (Commonwealth's Br. at 9-10 (emphasis in original).) The Commonwealth contends that this misunderstanding further shows that our alleged requirement for mutual exclusivity between the BME and "real estate structure" definition was in error , as it "effectively renders the subcategories and separate delineation of property" in those definitions "as purely tautological." (*Id.* at 11-12.) Because the Court "appears to have been led astray . . . and reached an erroneous conclusion," the Commonwealth maintains, "its decision should be reversed." (*Id.* at 12.)

Petitioner argues that the Court understood and addressed the Commonwealth's arguments. That our opinion's recitation of the Commonwealth's arguments and discussions of statutory terms was allegedly not "particular enough or fail[ed] to quote extensively enough[,]" Petitioner maintains, is not grounds for reversal. (Petitioner's Br. at 9.) Petitioner asserts that the Commonwealth "point[s] to no authority that says items must be" either BME or "real estate structure" "or any authority that

says [the Traffic Signal Related Purchases] must only qualify [as 'real estate structure'] and not BME." (*Id.* at 10.) Because the BME definition contains a per se list of those items that cannot be BME, Petitioner argues that the Code "simply offers a conclusion the Commonwealth disfavors." (*Id.* at 11.) Petitioner asserts that the Commonwealth fails to understand that our decision held that the Traffic Signal Related Purchases "are traffic signals[]" because "they are themselves objects that are used to convey information to control traffic[.]" (*Id.* at 12.)

2. Analysis

We first examine this Court's explanation of the Commonwealth's argument as it related to "structural supports" in *Kuharchik I* :

> As to Petitioner's argument that the Traffic Signal Related Purchases are encompassed within the term "traffic signals," the Commonwealth disagrees. Instead, the Commonwealth suggests that the Traffic Signal Related Purchases are "structural supports," and, therefore, are "real estate structure" not BME. Noting that **Section 201 (qq)** of the Code, **72 P.S. § 7201** (qq), defines the term "real estate structure" to include "structural supports," the Commonwealth asserts that the Traffic Signal Related Purchases cannot be BME because they are included within the [***16**] term "real estate structure." With respect to legislative intent, the Commonwealth contends that "it is clear the [L]egislature did not intend for structural supports to qualify for the BME exemption" since structural supports fall within the "real estate structure" exception to the use tax, which Petitioner does not qualify for as a construction contractor.[] (Commonwealth's [Principal] Br. at 14.)

Kuharchik I, **236 A.3d at 129** (footnote omitted) (alterations in original). While we later referred to the term "support structures" in the analysis section of our opinion, the above excerpt shows that this Court understood the Commonwealth's argument to be in regard to the specific statutory term "structural supports."

Looking to our alleged conflation of the terms concerning traffic and traffic control, the Commonwealth focuses on the following passage:

> [T]he Code defines "real estate structure" to include BME, evidencing that an item that is BME can also be considered "real estate structure." [**72 P.S. § 7201(qq)**]. Additionally, the Code defines "real estate structure" to include "**traffic control devices**." ***Id.*** Seeing that **traffic control items** are used in both the definitions of BME and "real estate structure," it is clear the definitions of BME and "real estate structure" overlap. Further, while the Traffic Signal Related Purchases are support structures in the sense that they support and elevate the **traffic signal head**, the Traffic Signal Related Purchases, for the foregoing reasons, are included within the term "**traffic signal**," which is specifically included with the definition of BME.

Kuharchik I, **236 A.3d at 134** (alterations and emphasis added).

The Commonwealth argues that our use of these terms demonstrates that the Court disregarded statutory language. We disagree. Rather, our review of the use of these terms shows that we considered the entirety of both **Section 201(pp)** and **(qq)** in order to draw inferences from the overlap between the items that qualify as BME and "real estate structure." Indeed, we agree with Petitioner that these Exceptions demonstrate that the Commonwealth has misinterpreted our statutory construction analysis as relying on the lack of exclusivity between these sections of the statute as the reason for determining that the Traffic Signal Related Purchases were within the common meaning of "traffic signals." For the reasons previously discussed, we see no error in our statutory construction analysis. Moreover, the Commonwealth's argument that our holding renders the subcategories and delineation of taxable and nontaxable items tautological because we required exclusivity between the statutes is based on a mistaken premise—that the holding requires any such exclusivity. Given that our decision provided no such holding, as discussed above, the Commonwealth's argument is without merit.

Accordingly, we disagree with the Commonwealth that we misunderstood its argument or that we conflated statutory terms and deny these Exceptions.

D. Whether this Court's factual findings were inconsistent with, unsupported by, or contradictory to the [*17] Stipulation.

1. Parties' Arguments

The Commonwealth takes Exceptions to the Court's following factual findings in *Kuharchik I* : (1) that Petitioner purchased items similar to the Traffic Signal Related Purchases "during the period of the [p]rior [a]udit," (Exceptions ¶ 5(a)); (2) "[t]hat Petitioner suggested to the Auditor that the [Traffic Signal Related Purchases] were not taxable because they qualified as BME[,]" (*id.* ¶ 5(b)); (3) that the BOA determined that the Traffic Signal Related Purchases were not BME but fell under the definition of "real estate structure," which did not apply to Petitioner as a construction contractor, (*id.* ¶ 5(c)); (4) that the record lacks any prior Department interpretation as to the meaning of "traffic signals," (*id.* ¶ 5(d)); (5) that the Commonwealth did not argue that the Department's interpretations were to be afforded deference, (*id.* ¶ 5(e)); (6) that Exhibit H to the Stipulation shows that the Traffic Signal Related Purchases are necessary for a traffic signal to function or is a "sample traffic signal plan" (*id.* ¶ 5(f), (g)); and (7) "[t]hat the Traffic Signal Related Purchases" are necessary "to elevate a traffic signal head above traffic[,]" (*id.* ¶ 5(h)).

In its brief, the Commonwealth argues first that our recitation of the BOA's and Board's decisions was inconsistent with the Stipulation. (Commonwealth's Br. at 7, 8 n.8 (citing *Kuharchik I*, **236 A.3d at 126**).) With respect to prior Department interpretations of the term "traffic signals," the Commonwealth maintains that our statement in *Kuharchik I* that "'the record

discloses no regulations, informal agency interpretations, policy statements[,] or other indication[] of the Department's interpretation of 'traffic signals' prior to this case[]' . . . is not accurate." (*Id.* at 12 (quoting *Kuharchik I*, **236 A.3d at 132**).) The Commonwealth argues that "[t]he record contains ample documentation demonstrating prior interpretations of the BME definition, generally, and the poles at issue here[.]" (*Id.* (citing Stip. at 789-851).) The Commonwealth contends that these interpretations show that the Department considers the Traffic Signal Related Purchases to be taxable, non-BME items. (*Id.* at 12 n.17 & n.18.) Finally, the Commonwealth argues that its principal brief contained an argument for deference to these Department interpretations and that our statement in *Kuharchik I* to the contrary was in error . (*Id.* at 13.) As to the remaining Exceptions to our alleged factual mistakes in *Kuharchik I* , the Commonwealth does not address or develop these arguments in its briefs.

With regard to deference to the Department's prior interpretations, Petitioner argues that, contrary to the Commonwealth's position, the Commonwealth "d[id] not state in its brief below that it is entitled to such deference in the instant action." (Petitioner's Br. at 12-13.) Rather, Petitioner maintains that "the Commonwealth never plainly stated that it is entitled to deference" and that "[t]he Commonwealth can point to no regulations, interpretations, or policy statements that would entitle it to deference." (*Id.* at 13.)

2. Analysis

Starting first with the Commonwealth's Exception to our recitation of the BOA's and Board's decisions in **[*18]** this matter, we stated the following in *Kuharchik I* :

> The Board reduced the use tax deficiency . . . but denied Petitioner any relief with respect to the Contested Items. ([Stip.] Ex. F.) The Board found that Petitioner had not met its burden of demonstrating that the [Traffic Signal Related Purchases] fell within the definition of BME. (*Id.* Ex. F at 7.) Further, the Board agreed with the [BOA's] conclusion that the [Traffic Signal Related Purchases] instead fell within the real estate structure exception to the use tax, which does not apply to Petitioner "since property used by construction contractors . . . for or on behalf of the Commonwealth or its political subdivisions[] is subject to tax." (*Id.* (quoting **Section 32.23(b)** of [the] Department's regulations, **61 Pa. Code § 32.23(b)**).)

Kuharchik I, **236 A.3d at 126-27** (sixth alteration in original). In its decision, the BOA stated that the "traffic signs along with other types of signage including the mast arms, poles, pole bases, anchor bolts and the like would represent real estate structure if [] Petitioner's contract was with an exempt entity[]" but that the exemption was not available because the items were purchased pursuant to a construction contract. (Stip. Ex. D at 2.) Therefore, it appears that the BOA did determine that the Traffic Signal Related Purchases fell within the real estate structure exception. Looking to the Board's decision, it stated that "Petitioner ha[d] failed to demonstrate that the purchases of the poles (anchor-bolted) with mast arms . . . constitute exempt traffic control systems equipment within the term [BME] as defined in **Section 201(pp)** [.]" (Stip. Ex. F at 7.) The Board added that the "traffic signs fall within the term 'real estate structure'" under **Section 201(qq)** . (*Id.*) Thus, it appears that it was incorrect to state that "the Board agreed with the [BOA's] conclusion that the [Traffic Signal Related Purchases] fell within the real estate structure exception to the use tax[,]" as the Board only explicitly held as much with regard to traffic signs. *Kuharchik I*, **236 A.3d at 126** .

Nonetheless, the Commonwealth has not explained how this factual inconsistency in our recitation of the Board's decision justifies reversal in this case. Beyond a passing reference to this recitation in its brief, (Commonwealth's Br. at 7-8 n.8), the Commonwealth does not develop any argument as to how this Exception would require us to reverse our holding. Given that this Court did not rely on the Board's or BOA's determinations but instead engaged in its own *de novo* review[7] to determine the common usage of the term "traffic signals" and whether the Traffic Signal Related Purchases fell within that meaning, and absent any argument developing how this inconsistency impacted our legal determination, we disagree with the Commonwealth that this factual inconsistency mandates reversing our decision.

Next, we turn to the Commonwealth's Exceptions surrounding the Department's prior interpretations of the term "traffic signals." In *Kuharchik I* , we stated that "the record discloses no regulations, informal agency interpretations, policy statements, or other indication of Department's interpretation **[*19]** of 'traffic signals' prior to this case, nor does the Commonwealth argue that its interpretation here should be given deference." **236 A.3d at 132** . The Commonwealth points to the Stipulation, arguing that it contains ample examples of the Commonwealth's interpretation. (Commonwealth's Br. at 12 (citing Stip. at 789-851).) After reviewing these cited pages of the Stipulation and the other exhibits attached thereto, the Court has not found any Department interpretation as to "traffic signals." While there are ample interpretations as to the taxability of other items such as "Power Poles," "Fabricated metal supports for fixtures and equipment," "Misc clips, angles[,] and metal," "Support Steel," and "Structural Steel, Joints," (Commonwealth's Br. at 12 n.17), the cited parts of the Stipulation contain no interpretation as to "traffic signals."

To this point, the Commonwealth also argues that we erred in stating that the Commonwealth did not argue that we were to give deference to the Department's interpretation as to "traffic signals." In its principal brief on the merits filed prior to our deciding *Kuharchik I* , however, the Commonwealth did not point to any specific interpretation or specifically argue that this interpretation is to be given deference. Rather, the Commonwealth summarily stated that "[c]ourts give deference to interpretations of statutes by administrative agencies possessing special or expert knowledge in complex areas of law like taxation." (Commonwealth's Principal Br. at 12-13 (citations omitted).) The Commonwealth did not explain to which

Department interpretation this Court was to afford deference. Moreover, as discussed above, given that our review of the Stipulation shows that there is no such Department interpretation as to the taxability of "traffic signals," this argument is not persuasive.

As to the remaining Exceptions to our decision's alleged factual inconsistencies, the Commonwealth does not address these Exceptions in its brief or explain how the challenged factual statements are inaccurate or contradict the Stipulation, much less how they would justify reversal even if so. Moreover, issues raised but not developed in an appellate brief are waived. *See Singer v. Bureau of Pro. & Occupational Affs., State Bd. of Psychology*, **159 Pa. Commw. 385 , 633 A.2d 246 , 248** (Pa. Cmwlth. 1993); *see also* **Rule 2119(a) of the Pennsylvania Rules of Appellate Procedure , Pa.R.A.P. 2119(a)** (requiring that the argument section of a brief be "be divided into as many parts as there are questions to be argued[]" and "followed by such discussion and citation of authorities as are deemed pertinent[]"). Accordingly, we deny these Exceptions.

III. CONCLUSION

For the foregoing reasons, we discern no error in our prior decision, and, therefore, we overrule the Commonwealth's Exceptions to *Kuharchik I* .

RENÉE COHN JUBELIRER, Judge

Judge Fizzano Cannon did not participate in the decision in this case.

ORDER

NOW, October 14, 2021, the Exceptions filed by the Commonwealth of Pennsylvania are **OVERRULED**. This matter is remanded to the Board of Finance and Revenue to reduce the use taxes assessed against Kuharchik Construction, [*20] Inc. for the period of January 1, 2011, through January 31, 2014, in accordance with the foregoing opinion and the parties' Joint Stipulations of Fact filed with this Court.

Jurisdiction relinquished.

RENÉE COHN JUBELIRER, Judge

fn 1

In *Kuharchik I* , the "Contested Items" included signal poles with mast arms, light poles with mast arms, camera poles with mast arms, and pedestal bases. *Kuharchik I*, **236 A.3d at 125** . We reversed the Board's order in part, holding that of these contested items, only the Traffic Signal Related Purchases were exempt from the Commonwealth's use tax. However, we affirmed in part because the remaining contested items were subject to the use tax. ***Id.* at 140** .

We also held that the Commonwealth's failure to assess use taxes in a prior audit against items related to the contested items in this matter did not equitably estop the Commonwealth from subsequently assessing such taxes. ***Id.* at 139-40** . Because Petitioner has not filed any exceptions to this holding, we will not address it further.

fn 2

Act of March 4, 1971, P.L. 6, *as amended*, **72 P.S. § 7201(pp)** .

fn 3

The Commonwealth's Exceptions have been combined and reorganized for ease of discussion. The Commonwealth also took exception to our "determination that Pennsylvania Courts have [n]ever applied equitable principles to bar the Commonwealth from exercising its tax assessment power." (Exceptions ¶ 10 (emphasis omitted).) Given that we found in favor of the Commonwealth with regard to this issue, holding that any representation from the Department as to the prior audit against Petitioners would not operate to estop the Commonwealth from assessing use taxes, *Kuharchik I*, **236 A.3d at 140** , this Exception is not a basis for reversing our opinion.

fn 4

Act of December 5, 1936, Second Ex. Sess., P.L. (1937) 2897, *as amended*, **43 P.S. § 753(*I*)(2)(B)** .

fn 5

Act of March 3, 1978, P.L. 6, *as amended*, **73 P.S. §§ 1881-1889** .

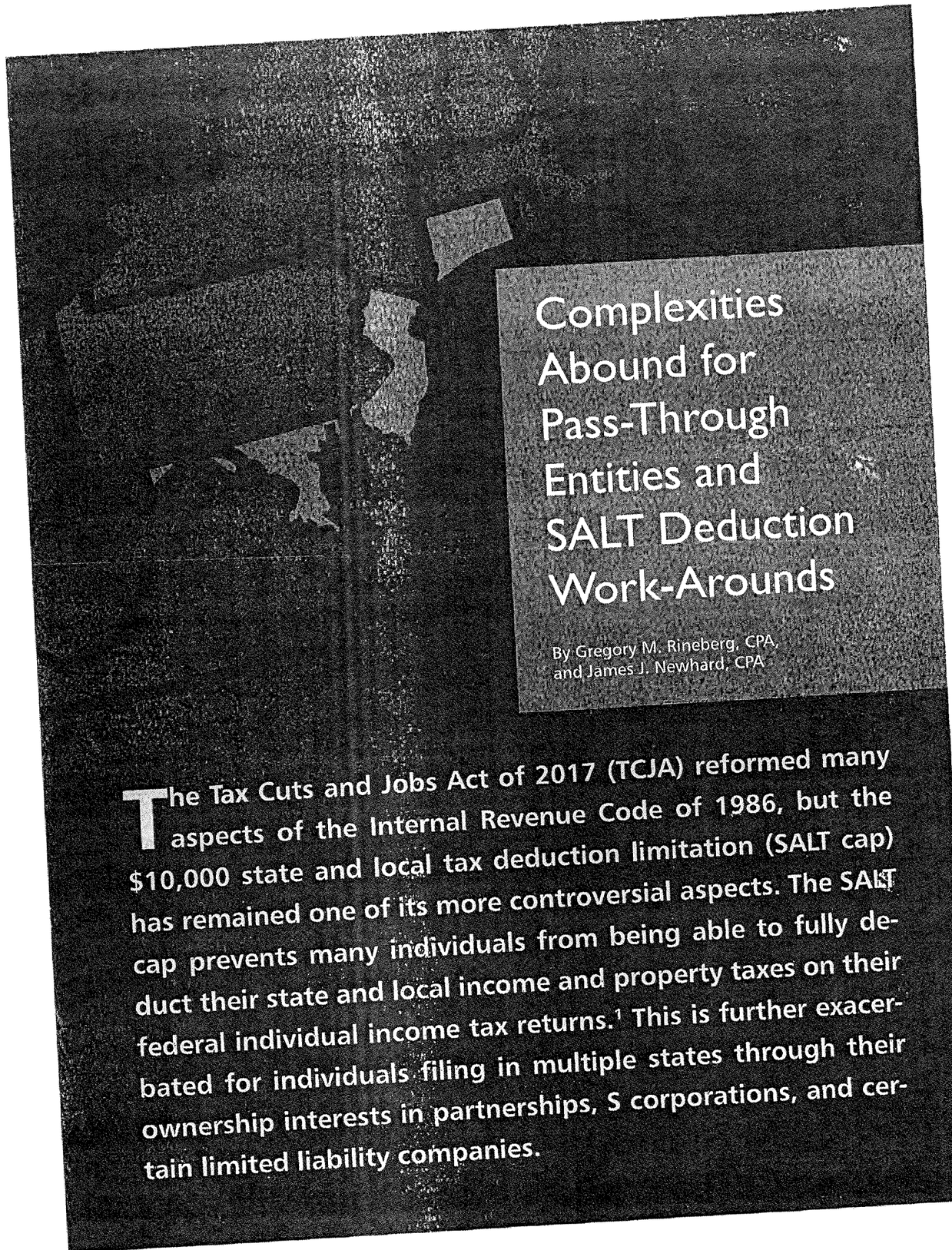
fn 6

Section 1201-A of the Tobacco Products Tax Act was added by Section 18 of the Act of July 13, 2016, P.L. 526, **72 P.S. § 8201-A** .

fn 7

In *Kuharchik I* , we explained that when reviewing determinations of the Board, "this Court essentially acts as a trial court and exercises the broadest scope of review.

Our standard of review is *de novo*. The stipulation of facts entered into by the parties is binding on them, although the Court may draw its own legal conclusions." *Kuharchik I*, **236 A.3d at 127 n.2** (quoting *Luther P. Miller, Inc. v. Commonwealth*, **88 A.3d 304** , **308 n.5** (Pa. Cmwlth. 2014)).



Complexities Abound for Pass-Through Entities and SALT Deduction Work-Arounds

By Gregory M. Rineberg, CPA, and James J. Newhard, CPA

The Tax Cuts and Jobs Act of 2017 (TCJA) reformed many aspects of the Internal Revenue Code of 1986, but the $10,000 state and local tax deduction limitation (SALT cap) has remained one of its more controversial aspects. The SALT cap prevents many individuals from being able to fully deduct their state and local income and property taxes on their federal individual income tax returns.[1] This is further exacerbated for individuals filing in multiple states through their ownership interests in partnerships, S corporations, and certain limited liability companies.

To mitigate the impact of the SALT cap, states have experimented with work-arounds that allow the deduction of additional state taxes on federal returns. Several created government-sponsored charities to convert limited state tax deductions to charitable contribution deductions. However, the IRS published regulations expressly denying this work-around.[2] Other efforts likewise did not appear to be effective, except for a pass-through-entity-level tax (PTE tax). Pass-through entities can be a partnership, an S corporation, or a limited liability company treated as a partnership for federal income tax purposes. The PTE tax is not a privilege tax or a franchise tax that the pass-through entity pays, but rather an income tax. Contrary to other types of entity-level taxes, this is an entity-level income tax with a credit for owners to claim on their respective state individual income tax returns.[3] Currently, seven states either require or allow pass-through entities to pay PTE taxes on behalf of their owners (Connecticut, Louisiana, Maryland, New Jersey, Oklahoma, Rhode Island, and Wisconsin), and more are looking to enact similar PTE taxes.[4]

On Nov. 9, 2020, the IRS released guidance agreeing that pass-through entities may claim a federal tax deduction for PTE taxes paid (IRS Notice 2020-75). Although the IRS approved the PTE tax as a SALT cap work-around and there are a number of states that have some variation of the PTE tax, questions remain. One of the biggest is whether the Biden administration will eliminate or increase the SALT cap, and whether any changes would be retroactive. This feature addresses the tax and financial statement accounting treatment of PTE taxes under current law and U.S. generally accepted accounting principles (GAAP), with an income tax focus on states geographically close to Pennsylvania, such as Connecticut, Maryland, and New Jersey.

State PTE Taxes

Connecticut – Effective for tax years beginning on or after Jan. 1, 2018, Connecticut mandates pass-through entities to pay tax on behalf of its owners.[5] If a pass-through entity has Connecticut-sourced income, then it is required to pay tax on each owner's share of their income at a rate of 6.99% when the pass-through entity files its Connecticut Pass-Through Entity Tax Return (Form CT-1065/CT-1120SI). Although the pass-through entity pays tax at a rate of 6.99% on its owners' behalf, the owners don't receive the full credit for the tax paid. Each owner receives an offsetting credit based on the percentage of the owner's direct and indirect share of the PTE tax, which is shown on the Connecticut K-1. For the 2018 tax year, the credit percentage was 93.01%, and thereafter the credit percentage is 87.5%.

Maryland – Effective for tax years beginning after Dec. 31, 2019, Maryland allows pass-through entities to elect to pay tax on behalf of its resident owners at the entity-level.[6] The election must be made annually by the pass-through entity on its Maryland Pass-Through Entity Income Tax Return (Form MD 510).[7] Although Maryland has historically required pass-through entities to pay tax on nonresident owners' distributive or pro rata shares of income allocable to Maryland, the pass-through entity now has the ability to pay its resident owners' portion at a rate of 8% (state rate of 5.75% plus local county rate of 2.25%). Owners would receive a credit on their Maryland K-1s equal to the amount of taxes paid by the pass-through entity and claim the credit on their respective Maryland individual tax returns. Maryland does not consider the PTE tax to be paid on behalf of the owners, but rather a tax paid by the entity. Since the tax is paid by the entity, it could be difficult for owners to claim credits for PTE taxes paid to Maryland. It is expected that Maryland will provide clarifying guidance in the form of updated regulations.

New Jersey – Effective for tax years beginning on or after Jan. 1, 2020, New Jersey allows pass-through entities to elect to pay tax on behalf of its owners.[8] Rather than adding on the PTE tax to existing tax laws and forms, New Jersey created the Business Alternative Income Tax (BAIT). The annual election to file and pay the BAIT must be made prior to the original due date of the pass-through entity return and requires the consent of all owners or any person authorized to act on behalf of the entity. Additionally, at least one owner must be subject to the New Jersey gross income tax on their share of distributive proceeds. If the pass-through entity elects to participate, it must file New Jersey Form PTE-100 and pay the tax due on each owner's distributive share of proceeds at the entity level. The BAIT is imposed at a graduated rate commensurate with state taxable income, ranging from 5.675% to 10.9%. Each owner receives a credit on their NJ K-1 to claim against their gross income tax liability on their respective New Jersey tax returns.

Other states – Louisiana, Oklahoma, Rhode Island, and Wisconsin have enacted similar PTE taxes. While their administrative process may be different in terms of making an election and claiming credits on tax returns, the goal is the same: the pass-through entity would pay each owner's tax at the entity level as a work-around to the SALT cap. Currently, though, Connecticut is the only state that mandates pass-through entities to pay income taxes on behalf of their owners at the entity level.[9]

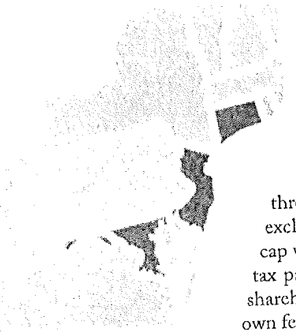
Income Tax Considerations

Federal tax benefit – There is a potentially significant federal tax benefit for pass-through entities that participate in states' PTE taxes since PTE taxes are currently expected to be fully deductible for federal income tax purposes. For example, assume each of Partnership A's partners owe tax of $100,000 to New Jersey based upon their pro rata share of the pass-through entity's New Jersey gross distributable income, and that each partner is already limited by the SALT cap due to other taxes. Prior to the BAIT program, these partners would have a federal tax detriment of roughly $37,000 ($100,000 x 37% statutory rate). By electing to participate in the BAIT program, each partner would receive a federal tax benefit of $37,000 as a result of the pass-through entity being able to fully deduct $100,000 as a business expense.[10]

Resident credits – A resident is taxed on all of his or her income in the resident state. Because he or she may also be taxed on the same income in nonresident states, a credit for taxes paid to nonresident states may be allowed. However, if a pass-through entity pays the individual's tax at the entity level, it is not clear if the resident would receive a nonresident credit for taxes paid to other states. The crux of the matter is whether states look upon a pass-through entity as separate and apart from its owners or as an aggregation of its owners. Under the aggregate theory, a state should allow a nonresident individual credit for taxes paid to another state by the pass-through entity since pass-through entities are nothing more than the sum of its parts. However, there are states that consider pass-through entities as standalone entities, and any income tax paid by the entity should not be considered as a nonresident credit available to residents. Maryland's guid- ▶

ance, for example, states that the PTE tax is an entity tax and not paid on behalf of owners. Pennsylvania only permits resident owners of an S corporation a nonresident credit for taxes paid to other states by a pass-through entity.[11] The credit is currently not available for resident owners of a partnership.[12] Thus, while a Pennsylvania resident shareholder can claim a nonresident credit for taxes paid by the pass-through entity, a Pennsylvania resident partner cannot. However, the Pennsylvania Department of Revenue has indicated there is the possibility that Pennsylvania would not allow a credit to shareholders since the New Jersey BAIT is an entity-level tax. Conversations regarding this position are ongoing. Each state has different rules regarding if and how an owner can claim a credit for income taxes paid to other states.

Practitioners should continue to closely monitor federal and state guidance, as well as the potential expansion of PTE taxes to other states.



Owners not subject to tax – It can be common for pass-through entities to have owners who are not subject to income tax. These owners could be tax-exempt, foreign, or simply have incurred a loss for federal income taxes in a given year. Generally, these owners should not have tax paid on their behalf by the pass-through entity. However, a consequence of electing to participate in a states' PTE tax could result in the pass-through entity overpaying taxes on behalf of owners who are not liable. This is primarily due to the fact that the PTE tax includes all owners. Assuming that an entity elects to participate in the PTE tax and remits tax for owners who are not subject to income tax, then those owners should be entitled to a refund. For example, if a pass-through entity with tax-exempt owners elects to pay the New Jersey BAIT, then those tax-exempt owners should be able to claim a refund for the amount of tax paid by the pass-through entity.[13] Currently, there is a not a prescribed refund form.

Accounting for PTE taxes – For accrued expenses, such as PTE taxes, to be deductible for federal income tax purposes, they must pass the all-events test. The test is satisfied when all events have occurred that determine the fact of liability and the amount of such liability can be determined with reasonable accuracy.[14] Therefore, unless a pass-through entity filed its election prior to Dec. 31, 2020, to participate in a state's PTE tax and estimated the tax liability, then it would not be able to claim those PTE taxes as a deduction on the 2020 federal tax return. Elections are required to be made annually before the end of the tax year if the pass-through entity wants to deduct its PTE taxes from the federal return. Specifically, the due date for an election in many of the states' regimes is not until the partnership's filing due date. This applies for the 2020 tax year as well as future tax years.

U.S. GAAP Financial Reporting

The Accounting Standards Codification (ASC), specifically ASC 740, *Income Taxes*, provides the guidance for companies to account for and report the effects of taxes based on income, and applies to federal, state, local, and foreign income taxes. Current federal tax law does not assess a general income tax on ordinary taxable income of pass-through entities, and prior to the TCJA neither did states. From a GAAP reporting basis, pass-through entities generally have had no income taxes applied at the entity level, with the income taxed at the proportionate share to the owner level. Accordingly, financial statement income tax disclosures are principally qualitative, limited to indicating the following:

- Income taxes are the responsibility of the equity investors.
- No income tax expense or benefit has been recorded.
- The company evaluates tax positions that would have a material effect on the financial statements.
- There are specified tax years that remain subject to examination by the IRS, states, or local taxing jurisdictions.

States that enacted entity-level income taxes on pass-through entities may allow some credit, deduction, or exclusion to the owners as a work-around to the SALT cap via specified income tax payments. A specified income tax payment is not an item of deduction that a partner or shareholder takes into account separately in determining its own federal income tax liability, and is not taken into account in applying the SALT deduction to any individual partner or shareholder. Accordingly, pass-through-entity financial statements will be required to apply ASC 740 to a measure, recognition, and presentation level, as well as an expanded disclosure requirement. Connecticut, Maryland, and New Jersey are relative neighbors of Pennsylvania and could have an impact on business entities for whom Pennsylvania CPAs provide services.

The ASC 740 objectives are as follows:

- Recognize the amount of taxes payable/refundable for the current year.
- Recognize deferred tax assets and liabilities for future tax benefits/consequences of events that have been recognized in an entity's financial statements.
- Convey the disclosures of the tax characteristics of the entity, its operations, its tax positions, its legal obligations, and off-balance-sheet items of carryover/carryback (including limitations and expirations), management's assessment of realization of future benefits (including valuation allowances), and other tax policies and/or elections with direct or indirect income tax implications or consequences.

ASU 2019-12, *Simplifying the Accounting for Income Taxes*, clarifies the necessity to bifurcate a tax assessed by a taxing jurisdiction levying a combined/alternative calculated tax determined by components that include a calculation based on income, irrespective of whether the other components calculated are franchise, value, gross receipts, or some other means of measurement. Accordingly, to the extent that the jurisdiction's levied tax equals or exceeds the amount calculated on net income, that portion must be recognized and characterized as income tax, and any remaining excess amount shall be charged as other operating tax expense.

ASC 740 will require maintaining and tracking, by state and

local taxing jurisdiction, the allocated, apportioned, and attributed items of position, income, expense, gain, and loss from those items constituting temporary differences (the difference caused by GAAP tax recognition policies as compared to the tax accounting recognition applied to and dictated by the applicable taxing authority). These differences will necessitate provisions for deferred tax assets and/or liabilities, along with expanded disclosures of carryover/carryback amounts and tax positions.

GAAP tax positions – In the context of GAAP, a tax position is a stance taken in a tax return that measures assets and liabilities that result in either a permanent or temporary deferral of income taxes, which includes current and previous returns, as well as returns "elected" not to be filed. Uncertain tax positions that may not be sustainable upon examination by taxing authorities – based on a required presumption that any and all tax positions on the return will be examined, regardless of the likelihood that this will actually occur – must be assessed and quantified, and a provision (liability) recognized to the extent a tax benefit would not meet a more likely than not (greater than 50%) threshold of being sustained upon examination. Further, provisions of both applicable penalty and interest must be recognized, either included with the tax provided or classified separately, applied consistently, and disclosed as an accounting policy. Generally, these provisions are classified as noncurrent liabilities, and may not be combined or netted with income tax liabilities on the balance sheet.[15]

Except for tax positions that never expire, the liability for uncertain tax positions will ultimately reverse when the statute of limitations expires or the position is examined and no longer "uncertain," even if disallowed.

ASC 740 requires the following disclosures for income taxes:

- Grossed-up amounts of deferred tax assets and liabilities netted on the balance sheet, including any valuation allowances
- The components of income tax expense related to continuing operations each year
- The types of temporary differences and carryforwards
- Reconciliation of taxes provided on continuing operations (private companies need only disclose the nature of these items)
- The amounts and expirations for operating losses or credits carried forward
- Any position of the valuation allowance for which subsequent benefits allocated reduce goodwill or intangible assets from an acquisition, or contributed capital
- Intraperiod tax allocations
- Specialized situations disclosures
- Classification policy for penalty and interest

Conclusion

It's important to note that electing to participate in PTE taxes may not be the best approach for all pass-through entities. A cost-benefit analysis should be conducted to determine if it makes business sense to elect to participate in a PTE tax, where not mandatory. The reality is that each state's PTE tax is different from the other. Due to administrative burdens, such as electing to participate, potential credit and refund issues, and a lack of state guidance on how to properly account for PTE taxes from an ASC 740 perspective, PTE taxes may create compliance complexity and costs in both the PTE tax states, the resident states, and with accounting and capital account maintenance. Other taxpayers may want to do tax planning by setting up pass-through entities specifically to take advantage of the federal deduction. Practitioners should continue to closely monitor federal and state guidance, as well as the potential expansion of PTE taxes to other states.

[1] Individuals in nonincome tax states may deduct sales taxes in lieu of income taxes.

[2] Contributions in Exchange for State or Local Tax Credits, 84 Fed. Reg. 27513 (June 13, 2019).

[3] "Owners" is used to include all individuals or entities that are partners, shareholders, or members in a partnership or S corporation.

[4] Currently, California, Illinois, and New York have introduced draft legislation to create a PTE tax.

[5] Matthew DiDonato, Arthur Burkard, and Rob Michaelis, "SALT Alert: Connecticut Legislation Responds to Federal Tax Reform," Grant Thornton LLP (June 19, 2018).

[6] Joel Waterfield, Guinevere Seaward Shore, and Jarryd Ritter, "SALT Alert: Multiple Maryland Tax Bills Enacted," Grant Thornton LLP (June 11, 2020).

[7] Comptroller of Maryland, Md. Income Tax Admin. Release No. 6, Taxation of Pass-Through Entities (2020).

[8] Matthew DiDonato, Bridget McCann, and Drew Vanden-Brul, "SALT Alert: New Jersey Enacts Elective Alternative Business Income Tax for Pass-Through Entities as Work-around to SALT Deduction Cap," Grant Thornton LLP (Feb. 11, 2020).

[9] The District of Columbia, New York, and Philadelphia have mandated PTEs pay income tax for owners at the entity level.

[10] The assumption is that the partner would receive the full benefit of not having to limit any of the $100,000 state and local tax deductions on Form 1040 since it was paid by the PTE. Assumed highest federal tax rate for individuals in 2020. The federal variable relative to possible savings in self-employment tax and the offsetting potential loss of qualified business income deduction was not factored in.

[11] 72 Pa. Stat. Ann. Section 7314.

[12] Pennsylvania Department of Revenue, FAQs: Credit for Entity Level Tax Paid by Pass-Through Entities (Answer ID 3618) (Jan. 31, 2019).

[13] N.J. Division of Taxation, Pass-Through Business Alternative Income Tax Act – FAQ (Dec. 23, 2020).

[14] IRC Section 461(h)(4) (2020).

[15] ASU 2013-11 does permit the netting of the tax-portion of the liability against deferred tax assets to the extent they relate to net operating loss or credit carryforwards.

Gregory M. Rineberg, CPA, is a state and local tax manager with Grant Thornton LLP in Philadelphia. He can be reached at greg.rineberg@us.gt.com.

James J. Newhard, CPA, is a sole practitioner in Paoli, a CPE presenter for Kaplan Financial Education, and a past-president of PICPA's Greater Philadelphia Chapter. He serves on numerous PICPA state and chapter technical committees, is a member of the Pennsylvania CPA Journal *Editorial Board, and serves on the AICPA PEEC committee. He can be reached at jim@jjncpa.com.*

Gregory M. Rineberg, CPA

James J. Newhard, CPA

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Good Shepherd Rehabilitation Network, Inc.	:	
v.	:	No. 1646 C.D. 2019 ARGUED: September 15, 2020
City of Allentown, Appellant	:	

BEFORE: HONORABLE MARY HANNAH LEAVITT, President Judge[1]
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE ELLEN CEISLER, Judge

OPINION NOT REPORTED

MEMORANDUM OPINION
BY JUDGE CEISLER

FILED: March 19, 2021

The City of Allentown (City) appeals from an order of the Court of Common Pleas of Lehigh County (trial court). The trial court sustained an appeal by Good Shepherd Rehabilitation Network, Inc. (Good Shepherd) from a decision of the City's Tax Appeal Board (Appeal Board) imposing the City's business privilege tax on Good Shepherd. The trial court found Good Shepherd, a nonprofit corporation, is not required to pay a business privilege tax to the City in relation to most of its income streams. After thorough review, we affirm the trial court's order.

I. Background

Good Shepherd is a Pennsylvania nonprofit corporation with its principal office in the City. Appendix D to Br. of Appellant, Trial court opinion, 10/15/19 (Trial Ct. Op.); Trial Ct. Op. at 2, Stipulations (Stips.) ¶¶ 1, 2. Good Shepherd is a tax-exempt organization under Section 501(c)(3) of the United States Internal

[1] This case was assigned to the opinion writer before January 4, 2021, when Judge Leavitt completed her term as President Judge.

Revenue Code, 26 U.S.C. § 501(c)(3). Trial Ct. Op. at 2, Stips. ¶ 3. Good Shepherd also holds a current tax exemption certificate from the Pennsylvania Department of Revenue (Department). Trial Ct. Op. at 2, Stips. ¶ 3.

Good Shepherd is the parent and controlling entity of three subsidiaries which are also Pennsylvania nonprofit corporations.[2] Trial Ct. Op. at 2-3, Stips. ¶ 4. Good Shepherd and its nonprofit subsidiaries are all recognized by the Department as institutions of purely public charity for sales and use tax exemption purposes. Trial Ct. Op. at 3, Stips. ¶ 5.

Good Shepherd provides administrative and financial services to its subsidiaries. Trial Ct. Op. at 3, Stips. ¶ 6. Those services include human resources, financial administration, information technology, fundraising, and building and operational maintenance. Trial Ct. Op. at 3, Stips. ¶ 6. If Good Shepherd did not perform these services, its subsidiaries would have to provide the services themselves by hiring additional staff or contracting with third parties. Trial Ct. Op. at 3, Stips. ¶ 7. Good Shepherd does not invoice or receive payment for these services; rather, it allocates its incurred costs of the services in its accounting journal entries, based on each subsidiary's proportionate share of generated revenues. Trial Ct. Op. at 5, Findings of Fact (F.F.) 1-2.

The City imposes a business privilege tax pursuant to its authority under Title Three, Article 333 of the City's Business Regulation and Taxation Code,[3] relating to

---

[2] Good Shepherd also owns rental property and a 2% interest in a medical laboratory facility, Health Network Labs, not categorized as nonprofit. Taxes related to those entities are not at issue here.

[3] Allentown, Pa., Business Regulation and Taxation Code, art. 333, §§ 333.01–333.99 (2019).

business privilege taxes.[4] Trial Ct. Op. at 3, Stips. ¶ 8. In December 2017, the City commenced an audit of Good Shepherd as part of an initiative of the City's Finance Department seeking to impose business privilege taxes on nonprofit corporations. Trial Ct. Op. at 4. The City then issued a Notice of Underpayment: Business Privilege Tax (privilege tax assessment) imposing privilege taxes against Good Shepherd for tax years 2007 through 2016, pursuant to the Local Taxpayers Bill of Rights Act (Taxpayer Rights Act), 53 Pa. C.S. §§ 8421 – 8438. Trial Ct. Op. at 3-4, Stips. ¶¶ 9-10. The privilege tax assessment was later revised to include only tax years 2012 through 2016,[5] and the assessed amount was reduced to $788,082.40. Trial Ct. Op. at 4, Stips. ¶ 13.

In May 2018, Good Shepherd petitioned the Appeal Board for review of the privilege tax assessment. Trial Ct. Op. at 4, Stips. ¶ 14. In July 2018, the Appeal Board held a hearing on the privilege tax assessment. Trial Ct. Op. at 4, Stips. ¶ 15. In August 2018, the Appeal Board issued a decision exempting Good Shepherd from the business privilege tax on donations (contributions, gifts, and grants) and reducing the business privilege tax assessment to $704,348.02. Trial Ct. Op. at 4-5, Stips. ¶ 16; Appeal Board's letter determination, 8/6/18, Br. of Appellant, App. A (Appeal Bd. Op.) at 4, Factual Determination (F.D.) No. 30. The Appeal Board otherwise upheld the imposition of the business privilege tax. Appeal Bd. Op. at 6.

Good Shepherd appealed the Appeal Board's decision to the trial court and requested a *de novo* hearing. The City opposed the hearing request, arguing that the

---

[4] The City has adopted a home rule charter. The subjects of its tax ordinances are authorized under the provisions of The Local Tax Enabling Act. *See* Act of December 31, 1965, P.L. 1257, *as amended*, 53 P.S. §§ 6924.101 – 6924.901.

[5] A further adjustment was made changing the period at issue to July 1, 2012, through June 30, 2017, to track Good Shepherd's fiscal year. *See* Trial Ct. Op. at 5, Conclusions of Law 1-3.

proceeding before the Appeal Board generated a complete record, and a *de novo* hearing would be improper under the Local Agency Law, 2 Pa. C.S. §§ 551-555, 751-754. The trial court heard argument on the propriety of a *de novo* hearing, after which it issued an order granting Good Shepherd's hearing request. The trial court's order did not set forth its reasons for granting the *de novo* hearing.

Following the *de novo* hearing, the trial court sustained Good Shepherd's appeal and found Good Shepherd was not required to pay the business privilege tax on contributions, gifts, grants, management fees, investment income, expense reimbursement, Health Network Labs revenue, insurance reimbursements, or management services. Trial Ct. Op. at 5, Conclusion of Law 3. The effect of the trial court's decision was to impose the business privilege tax only on Good Shepherd's rental properties and gross rents received. Trial Ct. Op. at 14. Good Shepherd does not dispute its responsibility for those taxes.

The City timely appealed the trial court's order to this Court. At the trial court's direction, the City provided a statement of errors pursuant to Rule 1925(b) of the Pennsylvania Rules of Appellate Procedure, Pa. R.A.P. 1925(b).[6] In addition to its assertion of error on the merits, the City specifically reasserted its argument that the *de novo* hearing was improper. Nonetheless, the trial court issued a one-sentence statement under Rule 1925(a) of the Pennsylvania Rules of Appellate Procedure, Pa. R.A.P. 1925(a) (Rule 1925(a)), resting on the reasoning in its original

[6] Rule 1925(b) of the Pennsylvania Rules of Appellate Procedure provides, in pertinent part, that "[i]f the judge entering the order giving rise to the notice of appeal . . . desires clarification of the errors complained of on appeal, the judge may enter an order directing the appellant to file . . . a concise statement of the errors complained of on appeal. . . ." Pa. R.A.P. 1925(b).

opinion.[7] Thus, neither the trial court's original opinion nor its Rule 1925(a) statement explained its reason for holding a *de novo* hearing.

II. Issues

The City raises two issues on appeal to this Court.[8]

First, the City asserts the trial court erred by conducting a *de novo* hearing rather than relying solely on the record developed before the Appeal Board. As a result, the trial court applied the wrong standard of review in analyzing the Appeal Board's decision.

Second, on the merits, the City argues the trial court incorrectly concluded Good Shepherd is not a "business," as that term is defined by the City's business privilege tax ordinance, for purposes of any privilege tax assessment on its contributions, gifts, grants, management fees, investment income, expense reimbursement, Health Network Labs revenue, insurance reimbursements, or management services.

---

[7] Rule 1925(a) of the Pennsylvania Rules of Appellate Procedure provides, in pertinent part, that "the judge who entered the order giving rise to the notice of appeal, if the reasons for the order do not already appear of record, shall . . . file of record at least a brief opinion of the reasons for the order, or for the rulings or other errors complained of . . . ." Pa. R.A.P. 1925(a). Here, the trial court's Rule 1925(a) statement was a single sentence indicating that its reasoning was fully explained in its original opinion.

[8] In a local tax appeal in which the trial court held a *de novo* hearing, this Court's review is limited to determining whether the trial court committed an abuse of discretion or made an error of law or whether constitutional rights were violated. *W. Clinton Cnty. Mun. Auth. v. Estate of Rosamilia*, 826 A.2d 52, 55 (Pa. Cmwlth. 2003) (citing *Otte v. Covington Twp. Rd. Supervisors*, 613 A.2d 183 (Pa. Cmwlth. 1992), *aff'd*, 650 A.2d 412 (Pa. 1994)). *See also In re Whitpain Twp. Bd. of Supervisors*, 942 A.2d 959, 961 n.6 (Pa. Cmwlth. 2008) (where trial court conducted hearing on stipulated facts, appellate review was limited to determining whether trial court committed error of law).

III. Discussion

A. Propriety of the *De Novo* Hearing

The City contends that under the Local Agency Law, the trial court was authorized to hold a *de novo* hearing only if it determined that the record developed before the Appeal Board was incomplete. The trial court made no such determination expressly, either in its decision or in its statement under Pa. R.A.P. 1925(a). Thus, the record does not indicate with certainty whether the trial court granted the hearing request because it concluded the Appeal Board record was incomplete, because it believed its authority to hold a *de novo* hearing was not limited by the Local Agency Law, or because of some other consideration.[9]

1. The Local Agency Law and the Taxpayer Rights Act

Good Shepherd argues that the trial court did not have to find the Board's record incomplete in order to grant a *de novo* hearing. Instead, Good Shepherd insists its appeal to the trial court was not subject to the Local Agency Law. Good Shepherd argues the Taxpayer Rights Act applies to its appeal, confers an absolute right to a *de novo* hearing, and thereby overrides the Local Agency Law's limitation, pursuant to Section 751(b) of the Local Agency Law. We agree.

Section 751(b) of the Local Agency Law states: "The provisions of this subchapter shall apply to any adjudication which under any existing statute may be appealed to a court of record, but only ***to the extent not inconsistent with such***

---

[9] For example, Good Shepherd argued that there were irregularities in the makeup of the Appeal Board such that a *de novo* hearing was required in order to avoid due process violations. In its memorandum of law in support of its request for a *de novo* hearing, Good Shepherd asserted that the Appeal Board failed to provide an independent, fair, and impartial tribunal. *See* Original Record, Item #17 at 1. However, the argument before the trial court concerning Good Shepherd's *de novo* hearing request was not transcribed, and the trial court provided no findings or written opinion on the issue, so it is not clear whether, or to what extent, the trial court relied on this contention by Good Shepherd in granting a *de novo* hearing.

statute." 2 Pa. C.S. § 751(b) (emphasis added).[10] Good Shepherd contends the Local Agency Law is inconsistent with the Taxpayer Rights Act.

> Section 8432 of the Taxpayer Rights Act provides:
>
> Practice and procedure under this subchapter ***shall not be governed by*** 2 Pa.C.S. Chs. 5 Subch. B [of the Local Agency Law] (relating to practice and procedure of local agencies) and *7* ***Subch. B*** **[of the Local Agency Law, 2 Pa. C.S. §§ 751-754]** ***(relating to judicial review of local agency action)***. The governing body shall adopt regulations governing practice and procedure under this subchapter.

53 Pa. C.S. § 8432 (emphasis added). Thus, the Taxpayer Rights Act provides that appeals from local tax agency determinations are governed by local ordinances of the taxing body, rather than by the Local Agency Law. Similarly, the City's Taxpayer Bill of Rights Disclosure Statement expressly sets forth that "[p]ractice and procedure before the City relating to tax appeal petitions is not governed by the Local Agency Law." Supplemental Reproduced Record at 7b.

The appeal provision of the City's business privilege tax ordinance provides: "Any person aggrieved by any decision of the Director of Administration and Finance shall ***as in other cases*** have the right to appeal to the Court of Common Pleas." Allentown, Pa., Business Regulation and Taxation Code, art. 333, § 333.05E

---

[10] For example, in *DeGore v. Civil Service Commission of Allegheny County*, 556 A.2d 29 (Pa. Cmwlth. 1989), this Court found the Local Agency Law's limitation on *de novo* hearings in a trial court did not apply where another statute – in that case, Section 10(f) of what is known as the Deputy Sheriff's Act, Act of May 31, 1974, P.L. 296, *as amended*, 16 P.S. §§ 4206-4221.16.H, granted a clear right to present additional evidence on appeal from a local agency's decision. 16 P.S. § 4221.10(f). In *DeGore*, the statute at issue provided that in an appeal from the Civil Service Commission to the trial court regarding a decision affecting a deputy sheriff, the trial court "shall" hold a hearing "on the original record and such additional proof or testimony as the parties concerned may desire to offer in evidence." 16 P.S. § 4221.10(f). This Court concluded that language conferred an absolute right to a hearing in the trial court. *DeGore*, 556 A.2d at 30. The City's ordinance here contains no parallel to this language.

(emphasis added). It is not clear what "other cases" the ordinance is referencing.[11] A search of the City's ordinances did not reveal any more detailed provisions concerning appeals to courts of record.

The City correctly points out that the ordinance provides only that the Local Agency Law will not apply to proceedings ***before the City***; the ordinance is silent about the Local Agency Law's application in appeals to court. Even so, given the Taxpayer Rights Act's explicit carve-out language, as well as the directives contained in the City's Tax Code and Taxpayer Bill of Rights Disclosure Statement, we conclude that the Local Agency Law did not govern Good Shepherd's appeal to the trial court. More broadly, the Local Agency Law's restriction, limiting *de novo* hearings to cases with incomplete agency records, is inapplicable to appeals taken pursuant to the Taxpayers Rights Act. Given the absence in the Taxpayer Rights Act of any strictures regarding the trial court's standard of review, the trial court was free to develop and consider the record without deference to the record created by or the factual findings of the Appeal Board.[12] As such, the trial court properly elected

---

[11] For example, Section 5105 of the Judicial Code, 42 Pa. C.S. § 5105, provides a right of appeal from administrative agency decisions, but is not applicable here. Section 5105(a)(2) provides a right of appeal from a final order of any administrative agency. However, relief under Section 5105(a)(2) is generally limited to cases where such relief would be available in "action[s] in the nature of equity, replevin, mandamus or quo warranto or for declaratory judgment or for a writ of certiorari or prohibition . . . ." 42 Pa. C.S. § 5105(d)(2). Moreover, Section 5105 does not "supersede any general rule or rule of court or any unsuspended statute authorizing or requiring an appellate court to receive additional evidence or to hear the appeal de novo." 42 Pa. C.S. § 5105(d)(3).

[12] This is not to say that the trial court was *required* to create a new record from scratch. Instead, the parties could have stipulated to a set of agreed-upon facts and/or to submission of the Appeal Board's record, whereupon the trial court could have chosen to resolve this matter on the parties' briefs without taking any additional evidence. *See V.L. Rendina, Inc. v. City of Harrisburg*, 938 A.2d 988, 991 n.7 (Pa. 2007); *cf. King v. City of Philadelphia*, 102 A.3d 1073, 1077 (Pa. Cmwlth. 2014) ("Although not strictly bound by the Pennsylvania Rules of Appellate Procedure, [a] trial court, acting as an appellate court, may look to the Pennsylvania Rules of Appellate Procedure for guidance").

to hold a *de novo* hearing in this matter. *See In re Sullivan*, 37 A.3d 1250, 1256 (Pa. Cmwlth. 2012) (a court of common pleas is "the ultimate finder of fact" in an appeal made pursuant to the Taxpayer Rights Act).

B. Good Shepherd's Status as a "Business" under the Tax Ordinance

On the merits of Good Shepherd's appeal, the Appeal Board concluded Good Shepherd is a "business" as defined by the City's business privilege tax ordinance. The trial court found, to the contrary, that Good Shepherd is not a "business" under the ordinance with regard to most of its income streams and therefore is not subject to the City's business privilege tax in relation to those income streams. Both parties submitted evidence on that issue, resolution of which required a combination of findings of fact and conclusions of law.

1. Burden of Proof

In a tax assessment appeal, the taxpayer bears the burden of proving the assessment is invalid. *Carson Concrete Corp. v. Tax Rev. Bd. of Phila.*, 176 A.3d 439, 450 (Pa. Cmwlth. 2017) (citing *Ernest Renda Contracting Co. v. Commonwealth*, 532 A.2d 416 (Pa. Cmwlth. 1987)). The taxing authority has a *prima facie* burden of production, which it may satisfy by placing its assessment in evidence; the taxpayer then has the burden of responding with relevant credible evidence to rebut the assessment's validity. *Carson Concrete*, 176 A.3d at 450. However, tax statutes and ordinances are strictly construed, and any doubt concerning taxability is resolved in favor of the taxpayer. *Tax Review Bd. of Phila. v. Esso Standard Div. of Humble Oil & Ref. Co.*, 227 A.2d 657, 659 (Pa. 1967).

2. "Business" Status

The City Tax Code's business privilege tax provision defines a "business" as "any activity carried on or exercised for gain or profit in the City, including but not

limited to, the sale of merchandise or other tangible personalty or the performance of services." Allentown, Pa., Business Regulation and Taxation Code, art. 333, § 333.02.01. The Appeal Board determined that Good Shepherd is a "business" for privilege tax purposes. The trial court held it is not.

a. Purely Public Charity

Good Shepherd's status as a purely public charity is a critical factor for business privilege tax purposes. ***The City concedes that its ordinance expressly excludes from the business privilege tax "nonprofit corporations or associations operating as purely public charities."*** Br. of Appellant at 23 (quoting and discussing Allentown, Pa., Business Regulation and Taxation Code, art. 333, § 333.02.D.1) (emphasis added). Thus, a purely public charity taxpayer is, by definition, not a "business" for purposes of the City's business privilege tax.

The Appeal Board found that Good Shepherd "provided no evidence to prove it is entitled to exemption from taxation as a purely public charity." Appeal Bd. Op. at 3, F.D. No. 26 (footnote omitted). However, as discussed above, that finding ignored the City's express acknowledgment to the Appeal Board that the City was not challenging Good Shepherd's status as a purely public charity. O.R., Item #12, at 17-18. Therefore, to the extent the Appeal Board relied on its finding that Good Shepherd is not a purely public charity in concluding that Good Shepherd is a "business" subject to the City's business privilege tax, the trial court correctly found the Appeal Board's conclusion was in error.

Before the trial court, the parties expressly stipulated that Good Shepherd and its nonprofit subsidiaries "are all recognized as institutions of purely public charity by the Department for purposes of sales and use taxation," and the trial court adopted that stipulation as a fact. Trial Ct. Op. at 3, Stips. ¶ 5. The trial court did not

expressly decide the issue of Good Shepherd's status as a purely public charity for privilege tax purposes, because it concluded that regardless of Good Shepherd's status as a purely public charity, it is not a "business" subject to taxation under the City's business privilege tax ordinance. *See* Trial Ct. Op. at 13.

However, we find that the Department's classification of Good Shepherd and its nonprofit subsidiaries as purely public charities, the City's express concession and stipulation concerning that status before both the Appeal Board and the trial court, and the City's express acknowledgment that the City Tax Code excludes purely public charities from the business privilege tax, are dispositive. We find that Good Shepherd is a purely public charity, and as such, it is not subject to the City's business privilege tax.

However, the City also argues that Good Shepherd is a "business" because it provides services for compensation and its compensation scheme reveals a private profit motive. The City contends its business privilege tax provision "inherently" includes nonprofit entities. Br. of Appellant at 23. Thus, despite the City's multiple concessions concerning Good Shepherd's status as a purely public charity, the City now argues that Good Shepherd is not excluded from the business privilege tax because it is ***not*** a purely public charity under the *HUP* factors. We disagree.

The Appeal Board recognized the applicability of the test articulated in *Hospital Utilization Project v. Commonwealth*, 487 A.2d 1306 (Pa. 1985) (*HUP*), in determining whether an entity is a purely public charity. *See* Appeal Bd. Op. at 3-4 nn.3-4, F.D. No. 27. The *HUP* factors require that to qualify as a purely public charity, an entity must advance a charitable purpose, donate or render gratuitously a substantial portion of its services, benefit a substantial and indefinite class of persons

who are legitimate subjects of charity, relieve the government of some of its burden, and operate entirely free from private profit motive. *HUP*, 487 A.2d at 1317.

The City cites this Court's decision in *Sacred Heart Healthcare System v. Commonwealth*, 673 A.2d 1021, 1026 (Pa. Cmwlth. 1996), in which a healthcare entity was denied an exemption from sales and use tax. Similar to Good Shepherd, the taxpayer in *Sacred Heart* provided services to affiliated corporations. This Court found the taxpayer was not a purely public charity, stating that the specific management and administrative services at issue in that case were not charitable. *Id.* at 1025.

However, even assuming, *arguendo*, that the City's reliance on *Sacred Heart* might otherwise have some persuasive appeal, here, the City conceded before the Appeal Board that Good Shepherd is a purely public charity, and further, the City stipulated before the trial court that Good Shepherd is exempt from sales and use tax as a purely public charity. In light of that concession and stipulation, *Sacred Heart* offers no support for the City's position.

Moreover, to the extent that the City analogizes this Court's determination of the sales and use tax exemption in *Sacred Heart* to a determination of the business privilege tax exemption in this case, that analogy only undermines the City's position. If the two subjects of taxation are analogous, then a nonprofit entity that is exempt from the sales and use tax as a purely public charity, as Good Shepherd is here, is likewise exempt from the business privilege tax. For example, *HUP* concerned exemption from property taxes, but our Supreme Court couched its analysis of whether an entity is a purely public charity in terms that were equally applicable to all forms of taxation. *See generally HUP*.

The City further argues that the *HUP* test, as applied by the Lehigh County Court of Common Pleas in *Pinebrook Services for Children and Youth v. Township of Whitehall* (C.C.P. Lehigh, No. 97-C-2046, filed June 25, 1999), 1999 Pa. Dist. & Cnty. Dec. LEXIS 315, would compel a conclusion that Good Shepherd is not a purely public charity because it operates for gain or profit. This argument suffers from the same flaws as the City's argument under *Sacred Heart*.

Notably, *Pinebrook* is not binding on this Court. Moreover, its reasoning supports the trial court's decision rather than the City's position, as the court in *Pinebrook* found the nonprofit taxpayer was exempt from a municipal business privilege tax. Further, the City expressly recognizes that the court in *Pinebrook* reached its conclusion by applying the law to the specific facts of that case. Here, the facts as found by the trial court support its conclusion that Good Shepherd is exempt from the City's business privilege tax.

b. Payment for Services

The Appeal Board found as a fact that Good Shepherd "is paid" for the various services it provides to its nonprofit subsidiaries, "and those payments are included in the 'Management Fees' revenue stream." Appeal Bd. Op. at 3, F.D. No. 14. In a related finding, the Appeal Board stated that Good Shepherd "is not merely providing an 'accommodation' to [its subsidiaries], it is providing a service for which it is compensated." Appeal Bd. Op. at 4, F.D. No. 28.

In contrast, the trial court found as a fact that "Good Shepherd . . . does not issue invoices to its subsidiaries nor receive any payments from the subsidiaries for the services provided." Trial Ct. Op. at 5, F.F. No. 1. The trial court found that Good Shepherd merely "allocates the costs of such services to the subsidiaries based upon the proportionate share of revenues generated by the subsidiaries and makes

corresponding accounting journal entries and accounting adjustments." *Id.*, F.F. No. 2. Further, directly to the contrary of the Appeal Board, the trial court found that Good Shepherd provides services to its subsidiaries "as an accommodation to and for the benefit of the controlled entities (i.e.[,] the nonprofit subsidiaries)." *Id.* at 10. The trial court's findings of fact, which we may not disturb on appeal, adequately supported its conclusion that Good Shepherd did not "carry on or exercise any . . . activity for gain or profit" during the relevant tax years, *id.* at 5, Conclusion of Law No. 2, and therefore was not a "business" subject to the City's business privilege tax. *Id.* at 6.

c. Private Profit Motive

Next, the City contends that Good Shepherd has a private profit motive because its executive compensation structure includes the possibility of bonuses for achieving annual financial or marketplace performance benchmarks. Significantly, the parties dispute the amounts of the bonuses, their percentage ratio of bonuses to salaries, the frequency with which bonuses are achieved, and whether they provide a private profit motive. These determinations are heavily fact-specific. The trial court's findings of fact do not support the City's argument. We will not disturb those findings of fact on appeal.

The City also asserts that the trial court erred in relying on *School District of Philadelphia v. Frankford Grocery Co.*, 103 A.2d 738 (Pa. 1954), in which our Supreme Court found a corporation that was formed to make bulk purchases and provide other cost-saving services to its retail grocer members was not operating for gain or profit and therefore was not subject to taxation. The City argues that the trial court should instead have followed *Shelburne Sportswear, Inc. v. City of Philadelphia*, 220 A.2d 798 (Pa. 1966). In *Shelburne*, the taxpayer, a subsidiary of

a clothing manufacturer, was subject to taxation where its affiliate provided yarns that the taxpayer knitted into finished garments and returned to the affiliate in exchange for payment of the taxpayer's operating expenses. The City posits that the *Shelburne* court distinguished *Frankford* on the basis that the taxpayer in *Frankford* was organized in the form of a cooperative. *See* Br. of Appellant at 36. We reject this argument.

Although the City stresses that the taxpayer in *Frankford* was organized for the purpose of acting as a cooperative, its form was that of a business corporation. In any event, our Supreme Court found that form was not determinative: "***We are not concerned with the form but with the substance of its structure and operation in its cooperative activities.***" *Frankford*, 103 A.2d at 741 (emphasis added). The City's argument, which elevates form over substance and even errs concerning the form at issue, is contrary to our Supreme Court's reasoning in *Frankford*. The trial court acted within its discretion in concluding that the facts, as it found them, were analogous to those in *Frankford*.

The City argues that because Good Shepherd and its subsidiaries are all nonprofit entities, there is no risk of double taxation in imposing privilege taxes on Good Shepherd, as there was in *Frankford*. The relevant point, however, is that because all of the entities are nonprofit, Good Shepherd's performance of services on a cooperative basis to save costs is analogous to the cooperative purchases in *Frankford*. Indeed, the City concedes that "it is fair to say that [Good Shepherd] exists to pool resources and reduce costs . . . ." Br. of Appellant at 36. The nonprofit subsidiaries would not pay taxes if they provided the services at issue for themselves at higher costs, so there is no logical basis to tax Good Shepherd where it provides

those services without profit and allocates the costs among the subsidiaries that receive the services.

d. Separation of Income Streams

Finally, the City argues that even if some of Good Shepherd's income streams are exempt from the business privilege tax, the trial court erred in exempting "passive" revenue streams including investment income, expense reimbursement income ("pass-through revenue"), and Health Network Labs revenue. Br. of Appellant at 37-40. The City argues that Good Shepherd uses the related assets for the purpose of generating income, and therefore the resulting income streams should be subject to the business privilege tax. Accordingly, the City suggests that if this Court determines Good Shepherd is a "business" subject to the business privilege tax on these passive income streams, this matter should be remanded to the trial court for separate analysis of each revenue stream to determine the correct amount of each segment of the applicable tax. In light of our disposition of this appeal, we need not reach this issue.

IV. Conclusion

For the reasons discussed above, we find the trial court did not err in holding a *de novo* hearing. Further, we conclude the trial court did not abuse its discretion in finding that Good Shepherd is not a "business" subject to the City's business privilege tax on most of its income streams. Accordingly, we affirm the trial court's order.

ELLEN CEISLER, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Good Shepherd Rehabilitation Network, Inc.	:	
v.	:	No. 1646 C.D. 2019
City of Allentown, Appellant	:	

ORDER

AND NOW, this 19th day of March, 2021, the order of the Court of Common Pleas of Lehigh County is AFFIRMED.

ELLEN CEISLER, Judge

pennsylvania
DEPARTMENT OF REVENUE
www.revenue.pa.gov

Coronavirus Aid, Relief, & Economic Security (CARES) Act: Pennsylvania Taxability

The Coronavirus Aid, Relief, & Economic Security Act, more commonly known as the CARES Act, is a law that was established to help individuals who were financially affected by the COVID-19 pandemic in the United States. Below is information on CARES Act relief payments and how they are treated in Pennsylvania.

ANNUITY FUNDS FROM LABORERS' UNIONS

The taxability of an Annuity Fund distribution in 2020 from a Laborers' Union would not be affected under the CARES Act. Whether PA tax is applicable will depend on the specifics about the distribution and fund.

CORONAVIRUS-RELATED DISTRIBUTIONS (CRD)

Coronavirus-related distributions on retirement accounts allow taxpayers to spread their federal income tax burden on the distribution over three years. If the amount is paid back within three years, taxpayers may request a refund of federal taxes paid on the withdrawal.

Pennsylvania does not follow the federal provision on this. If the withdrawal meets the age or years of service requirement, then it is not subject to PA income tax. Otherwise, early distributions from retirement accounts are subject to tax to the extent that they were not already subject to tax at the time the money was contributed to the account.

In the event someone takes an early distribution from a retirement plan that would be subject to tax and subsequently pays it back, the department would not refund tax paid on that amount. Any reinvestment would be considered basis and wouldn't be taxable upon later distribution.

COVID DISASTER RELIEF PAYMENTS

COVID-19 disaster relief payments set up by employers or charities to be paid to employees do not constitute compensation for federal income tax purposes under IRC 139(a).

The department does not follow IRC § 139. The taxability of these payments would be dependent on the nature of the payments and would have to be reviewed on a case by case basis.

ECONOMIC IMPACT PAYMENTS (EIP)
FEDERAL STIMULUS CHECK

The stimulus checks, otherwise known as economic impact payments, being distributed by the federal government are not subject to Pennsylvania personal income tax. The payments are considered a rebate that is non-taxable in Pennsylvania. Additionally, Act 1 of 2021 (SB 109) that was signed by into law by the Governor specifically states the payments are not taxable under Pennsylvania's Tax Reform Code.

ECONOMIC INJURY DISASTER LOANS (EIDL)

The Economic Injury Disaster Loan (EIDL) program provides for an "advance" of up to $10,000 within 3 days of the loan application even before the loan is approved. Section 1110(e)(5) of the CARES Act provides that the EIDL "advance" does not have to be repaid (even if the loan is subsequently denied). Because the "advance" never has to be repaid (i.e., there are no conditions that have to be met to have the advance on the loan forgiven or discharged), the department will treat the "advance" as a grant which is not subject to tax.

GRANTS FROM LOCALITIES

Grants that businesses received from their localities due to COVID-19, that were not from the EIDL program, are not subject to PA income tax.

PAYCHECK PROTECTION PROGRAM (PPP)

Act 1 of 2021 (SB 109) that was signed into law by the Governor on February 5, 2021 states that Paycheck Protection Plan (PPP) loans used to pay business expenses during the COVID-19 pandemic that are subsequently forgiven by the lender are not taxable income for Pennsylvania personal income tax purposes. The bill also states that for PA personal income tax purposes no deduction may be disallowed for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan.

For corporate net income tax, Pennsylvania taxable income is based upon federal taxable income. Pennsylvania law does not include an add back to or deduction from federal taxable income for forgiveness of a Paycheck Protection Plan loan.

1099-C, CANCELLATION OF DEBT

The IRS has clarified that lenders should not file Forms 1099-C to report the amount of qualifying forgiveness of covered loans made under the Paycheck Protection Program administered by the Small Business Association. This is not required to be filed with the PA Department of Revenue as well.

PROVIDER RELIEF FUND (PRF)

The federal government has allocated $175 billion in payments to be distributed through the Provider Relief Fund (PRF) to support healthcare providers in the battle against the COVID-19 pandemic. The PRF distributes payments to healthcare providers to cover healthcare-related expenses or lost revenue due to COVID-19. The payments are nontaxable as grants for PIT Purposes.

This includes Health Resources and Service Administration (HRSA) claims reimbursements for uninsured patients.

STUDENT LOAN DEBT

The CARES Act provides that certain student loan repayments made by an employer up to $5,250 will not be subject to Federal Income Tax. However, these repayments are considered taxable for PIT purposes. The amount of the student loan debt repayment made by the employer on behalf of an employee should be included as compensation on the employee's PA-40 return.

Relief for Taxpayers During COVID-19 Pandemic

To help people facing financial challenges resulting from the COVID-19 pandemic, the Department of Revenue is providing many taxpayers with increased flexibility with regard to their tax obligations. The goal is to help Pennsylvania taxpayers and citizens impacted by the pandemic.

Provide Flexible Terms for New Payment Plans

The department has revised general payment plan guidelines to permit greater flexibility on payment amount and duration of time. Taxpayers now have the ability to request a payment plan for outstanding liabilities without the department imposing a lien. The department will also not require financial disclosure documentation for payment plans that are under $12,000 and can be resolved within 12 months.

- $6,000 and less – Plans up to 6 months
- $12,000 and less – Plans up to 12 months

Focused Customer Service

The department is available to answer taxpayer questions through its Online Customer Service Center, available at revenue-pa.custhelp.comOpens In A New Window. Taxpayers can find answers to thousands of common tax questions or submit their tax-specific questions to a department representative.

Collections and Enforcement Activities

In an effort to provide taxpayer service, enforcement staff will be available for businesses to discuss proactive ways to comply with Pennsylvania tax laws. Small and newly registered businesses are encouraged to contact local District Offices in an effort to help avoid falling into common tax pitfalls. The department will work with businesses to help them avoid common filing errors, navigate the department's website to locate specific guidance, and answer any questions about electronic filing and payment.

The department will continue to work to resolve debt for large and complex accounts that remain outstanding. In addition, the department will continue to pursue taxpayers that willfully avoid meeting their Pennsylvania tax obligations.

Non-filer Notices

The department will continue to send non-filer notices and conduct automated call campaigns for business taxes as a reminder of their obligations. Businesses are encouraged to file and remit online using e-TIDES, the department's online tax system for businesses. Find the REV-819 on the department's website for a schedule of return and prepayment due dates.

Once returns have been filed, taxpayers who have a financial hardship can take that opportunity to resolve any outstanding liabilities by entering into a payment plan using the department's new flexible terms.

Trust Fund Taxes

All collected trust fund monies must be reported and remitted in full in accordance with your filing frequency. The department will not issue an extension of payment dates related to trust fund taxes.

Tax Credit and Incentive Programs

Tax clearances statutorily required will continue to be administered timely to ensure that the commonwealth can fulfill contractual obligations to award benefits to those participating in economic development programs.

Board of Appeals

All in-person hearings will be suspended until further notice. During this time, taxpayers are strongly encouraged to file all appeals using the Board's online petition center at www.boardofappeals.state.pa.us. Read Board of Appeals Operations During COVID-19 Pandemic for more information.

§ 7201(m)(2)(ix); *Graham Packaging Company L.P. vs. Commonwealth, 882 A.2d 1076* (Pa.Cmwlth. 2005).

Moreover when a subscriber is accessing content of the information retrieval products, the subscriber is accessing tangible personal property as that term is defined under Act 84, 72 P.S. § 7201(m)(2)(iii), (iv) and (x). The resource content constitutes electronic access to taxable tangible personal property such as case reporters and statutory codifications, as well as to periodical articles such as law journals, loose leaf services, and other similar items. 61 Pa. Code § 31.29. Whether or not access to resource content may be limited by the search function is not outcome-determinative because the grant of a conditional license to use tangible personal property is nonetheless a sale at retail under the TRC.

Accordingly, the information retrieval products constitute tangible personal property in that the transactions are comprised of both (i) a license to electronically access and use canned computer software and (ii) the right to electronically access tangible personal property. The transactions are therefore subject to the imposition of Pennsylvania Sales and Use Tax.

Wirth, E., et al, Aplts. v. Commonwealth - Nos. 82 - 85 MAP 2012
The Pennsylvania Supreme Court affirmed the commonwealth court's holding that a partnership was subject to personal income tax commensurate with the total debt discharged as a result of a foreclosure, and, therefore, the nonresident limited partners were liable for personal income tax in an amount proportionate with their shares in the partnership. The nonresidents had invested as limited partners in a Connecticut limited partnership, which existed for the sole purpose of owning and operating a skyscraper in the city of Pittsburgh, which went into foreclosure in 2005. Following the property's foreclosure, but prior to the partnership's liquidation, the partnership reported a gain as a result of the foreclosure on its federal and state tax filings that consisted of the unpaid balance of the partnership's principal and the accrued, compounded interest, totaling $2,628,491,551. The partnership reported each individual limited partner's respective share of that gain. Therefore, and despite their individual investment losses, the Department of Revenue levied income tax against the taxpayers, plus interest and penalties, related to the foreclosure on the property for tax year 2005. The amount taxed was each limited partner's distributive share of the gain associated with the foreclosure. The nonresident taxpayers' challenges to the assessments were denied by the commonwealth court.

http://www.pacourts.us/courts/supreme-court/court-opinions/

Peter N. Calcara, CAE | Vice President - Government Relations
Pennsylvania Institute of CPAs | 500 North 3rd Street, Suite 600A | Harrisburg, PA 17101
(717) 232-1821 | Fax (717) 232-7708 | www.picpa.org

pennsylvania
DEPARTMENT OF REVENUE

SALES AND USE TAX BULLETIN 2021-01

Sales and use tax exemption for non-medical masks and face coverings

Issued: January 20, 2021

Effective Date: October 30, 2020

The Department of Revenue ("Department") issues this Sales and Use Tax Bulletin to inform persons responsible for charging, collecting and remitting sales tax of the tax treatment of non-medical masks and face coverings.

Medical supplies, including medical and disposable surgical masks, are exempt from Pennsylvania sales tax. 72 P.S. § 7204(17); Retailer's Information Guide (REV-717). Prior to COVID-19, non-medical masks and face coverings were subject to sales tax because non-medical masks and face coverings were generally classified as ornamental wear or clothing accessories and the use for which consumers purchased non-medical masks and face coverings was not for an exempt purpose. 72 P.S. § 7204(26); Retailer's Information Guide (REV-717). Retailers were not obligated to determine whether a non-medical mask or face covering would be used for medical purposes because "[t]he determination that purchases qualify for exemptions as…medical supplies and the like, is based essentially upon the use for which the purchase are intended." 61 Pa. Code § 52.1(a).

On March 6, 2020, pursuant to the provisions of Subsection 7301(c) of the Emergency Management Services Code, 35 Pa. C.S. § 7101, *et seq.*, Governor Tom Wolf issued a Proclamation of Disaster Emergency in response to the COVID-19 pandemic, authorizing "all Commonwealth departments and agencies [to] utilize all available resources…as deemed necessary to cope with this emergency situation." In response to consumer demand for medical masks outpacing supply and leading consumers to use non-medical masks and face coverings[1] for medical purposes, namely to prevent and control the spread of COVID-19, the department responded with a statement that any non-medical cloth or disposable mask purchased for use as a means of protection against the virus was not subject to sales or use tax. Accordingly, the department will not assess retailers for failing to collect sales tax on purchases of non-medical masks and face coverings. Additionally, consumers who can certify to the department that a cloth or disposable non-medical mask or face covering was purchased and used as a means of protection against the virus can petition the department for a refund of any sales or use tax paid.

As of October 30, 2020, in response to the ubiquitous use of non-medical masks and face coverings, the department recognizes that both cloth and disposable non-medical masks and face coverings are exempt from sales and use tax as everyday wear or clothing.

---

[1] The Pennsylvania Department of Health, in its November 17, 2020, Updated Order Requiring Universal Face Coverings, defines "face covering" as "covering of the nose and mouth with material that is secured to the head with ties, straps, or loops over the ears or is wrapped around the lower face." It can be "made of a variety of synthetic or natural fabrics, including cotton, silk, or linen" and "may be factory-made, sewn by hand, or improvised from household items, including, but not limited to, scarfs, [or] bandanas."

pennsylvania
DEPARTMENT OF REVENUE

INFORMATION NOTICE
SALES AND USE TAX 2014-02

Natural Gas Mining

Issued: September 22, 2014

General Overview

The Department of Revenue (the "Department") provides this Sales and Use Tax Information Notice to taxpayers in the natural gas mining industry and related activities. Pennsylvania law exempts the purchase of taxable tangible personal property and services from tax when such property and services are predominantly used directly in mining activities (the "mining exemption") 72 P.S. §§ 7201(k)(8) and (o)(4). The Department's Mining Regulation set forth at 61 Pa. Code § 32.35 governs the scope of the mining exemption. This Information Notice applies the law, the Mining Regulation and other applicable regulations specifically to the natural gas industry and related activities.

Mining activities are defined in the law and regulations as including exploring, extracting, blasting, mining, or drilling for purposes of removing natural resources from the earth or refining natural resources removed from the earth. For natural gas mining, these activities would include cementing (pumping of cement slurry to bond casing or piping to the wall of the bore hole), fracturing (using fluids, a mixture of water and chemicals, to crack the rock formation and the injection of proppants such as sand and ceramic materials into cracks in the formation to open channels through which the gas flows) and acidizing (injecting acid below rock fractures to create flow channels within the rock formation). In this Information Notice these activities will be collectively known as "gas mining".

The mining exemption applies to the purchase or use of tangible personal property or services predominantly used directly in gas mining. Additionally, if a miner is entitled to purchase otherwise taxable property that is predominantly used directly in a gas mining activity exempt from tax, then a third-party vendor performing the same mining activity for the miner is also entitled to the exemption on the purchase of property predominantly used directly in that mining activity. *Commonwealth v. R.G. Johnson Co.*, 433 A.2d 465 (Pa. 1981).

However, the mining exemption does not extend to all property or services used in gas mining. The taxability determination of any property or services used in gas mining is fact-specific and depends on the use of the property or service as it relates to the mining process. The factors that determine whether property or services are directly used and thereby exempt are: (1) physical proximity to the mining operation, (2) temporal proximity to the mining operation, and (3) the existence of an active causal relationship between the use of the property and the mined product. 61 Pa. Code § 32.35(a)(1).

It is important to note that 61 Pa. Code § 32.35(a)(1)(iii) specifically states, in considering the existence of an active causal relationship, "[t]he fact that particular property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity does not, of itself, mean that the property is used directly in mining operations". Furthermore, when property is used in two different

activities, one of which is direct-use and the other is not, the property is not considered exempt property unless it is used more than 50% of the time in direct-use activities. 61 Pa. Code § 32.35(a)(2).

The mining exemption only applies to "[m]achinery, equipment, parts and foundations therefor, and supplies which are used in the actual mining production, to transport or convey the product ... [other than vehicles required to be registered under the Vehicle Code], or to handle or store the product during the production." 61 Pa. Code § 32.35(a)(2)(i) (emphasis added).

Consequently, property used prior or subsequent to the actual mining operation, to collect, convey or transport property to a mining activity or to remove the mined product after the final mining operation, and storage facilities or devices used to store property prior or subsequent to actual mining operation are subject to tax. 61 Pa. Code §§ 32.35(a)(3)(iii)(G) and (I). Similarly, property used in non-mining activities is subject to tax even if it is used during the mining operation. 61 Pa. Code § 32.35(a)(3)(iii)(H). For example, monitoring equipment that merely tracks and records drilling data is not exempt property even though it may be used during drilling operations.

A common issue in determining taxability is whether a transaction should be classified as a service or sale at retail of property. The answer often turns on the wording of contracts and invoices. Generally, if a transaction is determined to be a sale at retail of services that are predominantly used directly in exempt activities, then the service fees and any separately-stated charges incurred in conjunction with providing the services (*e.g.*, set-up fees, standby fees, travel costs or additional materials or labor fees, etc.) are also exempt.

If a transaction involves the sale at retail of property (which includes a rental or lease) and the property, such as equipment is furnished with the services of an operator with the charges for each billed separately, it is presumed that the transaction involves a transfer of the right to direct the use of the equipment. 61 Pa. Code § 31.4(a)(1). As such, the transaction is treated as equipment rental and provision of help supply services respectively. Assuming the leased property is taxable because it is not used predominantly and directly in mining, the rental charges are taxable. Furthermore, any additional charges incurred in conjunction with renting the taxable property such as those for set up time, standby time, additional pumping time, travel costs or additional labor or materials are also taxable. On the other hand, if the leased property is nontaxable, any separately stated charges incurred in conjunction with the exempt property (*e.g.*, set-up fees, standby fees, travel costs or additional materials or labor fees, etc.) are also exempt. However, the mining exemption is inapplicable to taxable help supply services. Thus, the separately-stated operator charges remain taxable regardless of the taxability of the rental property.

Also, no exemption is to be given to maintenance facilities or for materials or supplies to be used or consumed in construction, reconstruction, or remodeling of real estate other than exempt machinery, equipment and parts therefor that may be affixed to real estate. 72 P.S. §§ 7201(k)(8) and (o)(4); Pa. Code 61 § 32.35(a). Finally, vehicles required to be registered under 75 Pa. C.S. §§ 101-9909 (the "Vehicle Code").

Based on information currently available to the Department, the taxability of property and services commonly used in or in conjunction with gas mining is as follows:

A. Exploration

"Mining" as defined by law includes exploration for natural gas so otherwise taxable tangible personal property and services are exempt from tax when they are predominantly used directly in exploration. Examples of exempt exploration property and services include:

1. Seismic exploration services.
2. Exploratory well drilling services.
3. Seismic imaging services.
4. Seismic data.

B. Site Preparation & Pre-Production Construction

Generally, the mining exemption does not apply to property or services used in the construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate. The mining regulation further states that property used in the removal of trees and clearing of land in preparation for extraction activities is not directly used and therefore taxable.

1. Equipment, parts and materials used in site preparation including, but not limited to, removal of timber, building of access roads and removal of dirt and rocks from the land are taxable, including, but not limited to the following:
    a. Bulldozer.
    b. Backhoe/front loader.
    c. Stone for roads.
    d. Road fabric.
    e. Sluice pipe.
    f. Security fencing.
    g. Bridges and bridge construction materials.
2. Equipment, parts and materials used in the construction of ponds or any other vessels for storage of fresh water or raw materials prior to their use in drilling or hydraulic fracturing such as liners are taxable.
3. Geosynthetic materials used to store clean water used in the drilling operations are taxable.
4. Equipment, parts and materials used in the construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate even if the structure may house or otherwise contain equipment or other facilities used directly in mining are taxable.
5. Equipment, parts and materials used to construct an electrical system used to deliver electricity to exempt property from the point the electricity leaves the local distribution company transmission line to the point immediately prior to the last transformer prior to the exempt equipment are taxable. All property used to deliver electricity from this point to the exempt equipment, including the last transformer, is exempt from tax. If the equipment to which the electricity is delivered is taxable, the materials incorporated into an electrical system, even the last transformer and property between that transformer and the taxable equipment are taxable.

If the equipment the electricity powers is both taxable and nontaxable, predominant use determines the taxability of the materials incorporated into the electrical system. The building of the electrical system is a construction contract. Whatever the use of the equipment to which the electricity is delivered, equipment used to construct the electrical system is taxable if it is not incorporated into the electrical system.

C. Extraction and Production

For purposes of the mining exemption, the actual gas mining process begins with the drilling of the wellbore and ends with the last physical change of the gas prior to it being sold and transferred by the miner to another. Therefore, property and services predominantly used directly during this process are exempt.

1. Exempt

   a. The well pad and the foundation directly under the well pad including, but not limited to materials such as sand, stone, gravel or other similar material directly supporting the well pad and any materials used in the well pad itself such as liners and mats are exempt as pollution control property if the well pad was constructed after April 16, 2012 in accordance with 58 P.S. § 3218.2 (relating to containment for unconventional wells).

   b. Materials, such as liners, sand, gravel, etc. used in the construction of storage ponds or vessels from which fracturing fluids (a mixture of water and chemicals) are pumped into fracturing well holes. The exemption also applies to holding ponds, tanks and other containment vessels for fluids that are pumped from the well hole and reused in fracturing multiple wells.

   c. Digging and extracting equipment, machinery, and tools directly used in gas mining:

      i. Drilling rig unit.
      ii. Drilling head.
      iii. Drilling bits.
      iv. Drilling extensions.
      v. Drill string and downhole equipment.
      vi. Drilling mud.
      vii. Casing.
      viii. Cement to encase the casing.
      ix. Twin cement unit (a system located at the well site that mixes cement to be added to the batch mixer).
      x. A frack unit (affixed to the back of a truck chassis) and all repair parts and fuel used in running the fracturing unit, not including the licensed chassis.
      xi. Frack pumps (equipment that injects fluids into a rock formation).
      xii. Gases, sand and cement used in fracturing.
      xiii. Pumps used to extract gas from the ground.
      xiv. Pump down acid equipment (pumping equipment used to perform fracturing, which includes a positive placement pump to expand a

cavity and a boost pump for increasing system pressure of the operation).

xv. Pump rod (connected to the pump).

xvi. Acid pumper (equipment used to pump specially blended acid into the wellbore).

xvii. Bath mixer (equipment used at the well site to mix cement slurry).

xviii. Sucker pipe (pipe that allows oil to flow to the surface).

xix. Cap affixed to the top of the wellhead.

xx. Pump jack (provides upward and downward movement to the pump rod directly resulting in the operation of the pump).

xxi. Manifold trailer (equipment that attaches piping lines to the well head to facilitate the pumping operation).

xxii. Fishing or extracting tools used predominantly to retrieve and remove objects from a drilled hole during the drilling operation.

xxiii. Electricity or fuel used to run direct-use equipment.

xxiv. Frack tanks predominantly used to hold in-process materials, including flow-back water.

d. Remote control and accompanying monitoring equipment used to control and operate frack pumps, blenders and liquid additive units during fracturing only if the equipment makes automatic adjustments to the pumps, blenders, etc. during fracturing.

e. Lighting equipment and supplies used to light production activities. Protective devices worn by production personnel in their work. Communication devices such as handheld radios used predominantly in mining activities such as work coordination among production employees of equal authority.

f. Compression machinery and equipment used up to the last physical change of the gas prior to its being sold and transferred by the miner to another.

g. Refining machinery and equipment used to remove water, vapors or hydrocarbons from gas.

h. Waste extraction, removal, handling, disposal equipment and machinery used in the course of production operations.

   i. Half tanks – large open tanks hold drill cuttings during the course of drilling operation.

   ii. Geotechnical products such as liners used to hold contaminated fracturing water during the course of drilling operation.

   iii. Pit liner used in the sludge holding ponds to hold sludge during the course of drilling operation.

i. Pollution Control Devices

   i. Equipment, machinery and supplies designed and used to control, abate, or prevent air, water or noise pollution generated in the mining operation, including but not limited to flare stacks,

ii. Materials such as liners, sand and gravel used in constructing a pond used predominantly in controlling, abating, or preventing pollution generated in the mining operation.

iii. Geosynthetic materials used to prevent contamination generated in the mining operation.

iv. Back-up containment systems.

v. Erosion control property, such as silt fences, stakes or hay bales, is exempt, only if used to control, abate or prevent air, water or noise pollution generated in the mining operation.

j. Property to test and inspect the product up to the last physical change of the gas prior to its being sold and transferred by the miner to another party.

k. Reclamation machinery, equipment and materials such as bulldozers, graders, fill, seedlings, grass seed, shrubs, stone, concrete and soil nutrients used in backfilling and reclamation of directly used mining facilities only when the backfilling and reclamation is required by law.

l. Gyroscopes and the wireline with which a gyroscope is hoisted and lowered into the wellbore when the gyroscopic data is used by the miner to guide and direct equipment used during drilling production.

m. Any otherwise taxable property purchased by a nonresident outside of and brought into Pennsylvania for use in the Commonwealth for a period of not more than seven days.

2. Taxable

a. Equipment used to construct well pads.

b. Equipment used to construct ponds or other vessels for storage of fresh water, raw materials or in-process fluids.

c. Property, including liners, used in constructing ponds for storage of water prior to its use in drilling.

d. Property used in water transportation system that pumps water from a body of water to the water storage pond.

e. Property used in construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate even if the structure may house or otherwise contain equipment or other facilities used directly in mining.

f. Erosion control property, such as silt fence, stakes, hay bales, is taxable if such property is not used to control, abate or prevent air, water or noise pollution generated in the mining operation.

g. Pipe racks/pipe boats for pipe storage.

h. Fuel storage unit.

i. Sand or gravel storage unit.

j. Tanks predominantly used to store raw materials prior to use in a mining operation.

k. Mine management and administration.

i. Office furniture, supplies and equipment, textbooks and other educational materials, books and records and other property used in mining recordkeeping and other administrative and managerial work.

ii. Property, including but not limited to supplies used to record the quality and quantity of work in production or goods in storage, the flow of work, the results of inspection, or to instruct workers in routing work or other production activities.

iii. Property used to record the volume and pressure of gas coming from the wellhead.

iv. Communication devices used for managerial direction and supervision.

D. Transport

Machinery, equipment, parts and foundations therefor, and supplies used to transport or convey extracted product during production are directly-used in mining and therefore exempt.

1. Exempt

a. Transportation devices and equipment such as gathering lines used to transport gas from the wellhead to the miner's compression or refinery operations up to the last physical change of the gas prior to its being sold and transferred by the miner to another.

b. Pump and power for pump used to move the gas through a pipeline prior to the last change.

c. Pipes and any foundation materials directly under the pipes, such as sand, stone or other similar materials.

2. Taxable

a. Vehicles required to be registered under 72 Pa. C.S. §§ 101-9909 (the "Vehicle Code"), supplies, repair parts and repair services for the vehicles.

i. Truck chassis to which a drilling unit, frack unit, or service rig is affixed.

ii. Acid transport (a tractor trailer used to move raw or blended acid to well sites).

iii. Bulk truck (a truck that transport dry products to the batch mixer).

iv. Vehicles and trailers registered under the International Registration Plan ("IRP") as they are required to be registered under the Vehicle Code.

v. Cargo trailer such as an enclosed utility trailer that transports testing equipment.

vi. Chemical liquid additive tractor trailer that transports chemicals to be used at well sites. The unit maintains the temperature of the chemicals in transit.

vii. Chemical transfer tractor trailer used to transport the chemical liquid additive unit to well sites.

viii. Mechanic service truck.

ix. Crew bus.

x. Data van (a van used to house remote control equipment).

xi. Frack iron float (a tractor trailer that transports piping to the well site to connect the manifold and wellhead).

xii. Hydration unit (a tractor trailer hydration unit that mixes and retains fluids on the surface for polymers to hydrate).

xiii. Mobile food trailers.

xiv. Pick-up trucks.

xv. Sand conveyor (a trailer-mounted belt used at well site to transport sand from sand storage bins to the blender).

xvi. Sand storage bins (a mobile trailer storage bin with multiple compartments that delivers sand to the sand belt or directly to the containers for sand).

xvii. Sand transport (a tractor trailer used to transport sand from the bulk plant to the well site).

xviii. Equipment used to build the pipelines such as bulldozers, front loaders, or road fabric, except for equipment used in reclamation.

E. Vehicles and Special Mobile Equipment ("SME")

The mining exemption does not apply to any vehicles required to be registered under The Vehicle Code. Under the Vehicle Code, non-self-propelled SME are exempt from registration. Thus, such SME is eligible for the mining exemption if it is predominantly used directly in mining.

1. Exempt
    1. Non-self-propelled equipment with an SME-plate issued by the Pennsylvania Department of Transportation ("PennDOT") if used predominately and directly in gas mining.
    2. Non-self-propelled equipment without a SME-plate only if it is:
        i. Not designed for or used in transportation of property other than tools or parts for the equipment,
        ii. Primarily for off-highway use and only operates incidentally on the highway, and
        iii. Used predominantly and directly in gas mining.

    NOTE: The burden of proof is on the person who claims that equipment is an SME not required to be registered under the Vehicle Code. This burden will be met if the person obtains a written PennDOT determination that the equipment qualifies as a non-self-propelled SME, *e.g.*, frack tank trailers.

2. Taxable
    1. All self-propelled SME.
    2. Mobile dormitories and offices.

F. Gas Storage

The definition of "mining" includes the extraction of natural resources from stockpile. As such, the withdrawal of gas from gas storage is considered an exempt mining activity. Consequently, equipment predominantly used directly in withdrawing natural gas from a storage facility is exempt. On the other hand, equipment used to inject gas into storage, storage equipment and facilities for finished product are taxable.

G. Distribution

Meters used to measure gas usage of the property owner are taxable unless used by a public utility.

H. Research

Property used directly in research activities with the objective of producing a new or improved product or method of producing a product is exempt whereas property used in market research or in other research that is conducted with the objective of improving administrative efficiency is taxable.

I. Services

1. Maintenance, repair and cleaning services on exempt property are exempt, as are repair or replacement parts for exempt machinery and equipment. Operational supplies such as fuel, lubricants, paint, etc. are exempt if actively and continuously used in the operation of exempt machinery and equipment.
2. Maintenance, repair and cleaning services on taxable property are taxable. Also taxable are repair or replacement parts for taxable machinery and equipment.
3. The purchase or rental of property used to perform maintenance, repair and cleaning services are taxable regardless of the taxability of the property on which the services are performed. Equipment and supplies used in general cleaning and maintenance of mining property such as soaps, cleaning compounds, brushes, brooms, mops and similar items are also taxable.
4. Services, other than cleaning services, which do not alter the property on which the service is performed, such as calibration, inspection or testing, are exempt.
5. The other enumerated taxable services in the statute, including lobbying, adjustment services, collection services, credit reporting services, secretarial or editing services, disinfecting or pest control services, building maintenance or cleaning services, employment agency or help supply services, lawn care services or self-storage services are taxable even if directly used in a mining activity.

pennsylvania
DEPARTMENT OF REVENUE

SALES AND USE TAX BULLETIN 2012-01

Revised: November 15, 2013

Sales/Use Tax Issues for Mining Site Preparation

The Department of Revenue offers this sales and use tax guidance to taxpayers who clear land and prepare a site in anticipation of mining operations to be conducted at that site. This guidance is necessary because the Department's mining regulation, 61 Pa. Code § 32.35, details the application of the sales and use tax law as applied to traditional and strip mining, but is not as specific concerning modified or enhanced mining processes, such as hydraulic fracturing used in unconventional oil and gas well development. Although much of the work done for mining site preparation does not qualify for the mining exclusion, the exclusion is available for certain site work.

Pennsylvania law excludes from sales and use tax machinery, equipment, parts and foundations therefor, and supplies that are predominantly used directly in mining operations. 72 P.S. § 7201(k)(8); 61 Pa. Code § 32.35(a). Even if property may be considered essential to the conduct of the business of mining because its use is required either by law or practical necessity, that does not necessarily mean that the property qualifies for the tax exclusion. 61 Pa. Code § 32.35(a)(1)(iii). For example, property used prior to the actual mining operation, such as property used to store raw materials prior to their use in the mining operation, is not considered to be directly used in mining and is subject to tax. 61 Pa. Code § 32.35(a)(3)(iii)(G). Also, "property used for waste handling and disposal of pollutants other than in the course of production operations" is taxable unless the equipment, machinery and supplies are designed and used to control, abate or prevent air, water or noise pollution generated in the mining operation. 61 Pa. Code §§ 32.35(a)(2)(ii) and (a)(3)(iii)(J).

The regulation specifically states that the mining exclusion does not apply to property or services used in the "construction, reconstruction, alteration, remodeling, servicing, repairing, maintenance or improvement of real estate." 61 Pa. Code § 32.35(a)(3)(i). That clause further states that "property used to remove trees and clear ground preparatory to extraction activities is not deemed to be directly used" and therefore not covered by the mining exemption. *Id.*

Beginning April 16, 2012, if the rigging pad is constructed in accordance with 58 P.S. §3218.2 (Containment for Unconventional Wells, effective April 16, 2012) to control or abate pollutants generated in the mining operation, the materials used in the construction of the rigging pad, such as liners, sand and gravel, would be excluded from tax as a pollution control device.

Generally, equipment and parts used in site preparation – including, but not limited to, removal of timber, building of access roads and removal of dirt and rocks from the land – are taxable as pre-mining activities. However, the foundation directly underneath the drilling rig is excluded from tax. Therefore, although equipment used to build rigging pads is taxable, any foundation material supporting the drilling rig, such as sand, stone or other similar material, would be excluded from tax as foundation material for exempt mining equipment.

The construction of ponds or any other vessels for storage of fresh water or raw materials prior to their use in drilling or hydraulic fracturing is not a mining activity. Therefore, equipment used to construct these ponds and the actual materials used in the ponds, such as liners, are taxable pre-mining property. Ponds to be used to control or abate pollution generated in the mining operation, however, are excluded from tax. Therefore, although equipment used to build such ponds is taxable, any materials used in that construction, such as liners, sand and gravel, would be excluded from tax.

BOARD OF FINANCE AND REVENUE

INTERIM OPERATING RULES

CHAPTER 1. GENERAL PROVISIONS

Subchapter A. OVERVIEW

§ 1.1. Scope of interim rules.

(a) These interim rules, as may be amended, govern the practice and procedure before the Board.

(b) The interim rules, as may be amended, will govern until such time as regulations are promulgated that will supersede the applicability of 61 Pa. Code, Part 4, Board of Finance and Revenue, Chapter 701, and, to the extent applicable, 1 Pa. Code Part II (relating to general rules of administrative practice and procedure).

§ 1.2. Liberal construction.

(a) The interim rules shall be liberally construed to secure the just, speedy and inexpensive determination of every Proceeding before the Board. The Board at any stage of a Proceeding may disregard an error or defect of procedure that does not affect the substantive rights of the Parties.

(b) The Board at any stage of a Proceeding may waive a requirement of these interim rules, including a deadline, when necessary or appropriate, if the waiver does not adversely affect a substantive right of either Party.

§ 1.3. Definitions.

Subject to additional definitions contained in subsequent sections which are applicable to specific chapters or subchapters, the following words and terms, when used in this subpart, have the following meanings, unless the context clearly indicates otherwise:

Board - The Board of Finance and Revenue.

Business day – A day on which the Board's office is scheduled to be open excluding Saturdays, Sundays, or legal holidays.

Chairman – The State Treasurer or the State Treasurer's designee.

Confidential proprietary information – As defined in the Section 102 of the Act of February 14, 2008 (P.L. 6, No. 3) known as the Right-to-Know Law, codified at 65 P.S. § 67.102, Commercial or financial information received by an agency:

(1) that is privileged or confidential; and

(2) the disclosure of which would cause substantial harm to the competitive position of the person that submitted the information.

Department – The Pennsylvania Department of Revenue.

Electronic delivery — A method of dispatching or receiving a submittal via electronic means such as email or facsimile, or the Board's electronic filing system.

Order—A decision by the Board that becomes final unless a timely request for reconsideration is filed by a Party and is timely granted by the Board.

Party—A person who appears in a Proceeding before the Board. The term includes both a taxpayer and the Department, or in appeals filed under 72 P.S. § 503, the claimant and the opposing governmental agency.

Personal financial information - An individual's personal credit, charge or debit card information; bank account information; bank, credit or financial statements; account or PIN numbers and other information relating to an individual's personal finances.

Petition – An application to the Board in which Petitioner seeks relief or remedy.

Petitioner— A taxpayer or other claimant.

Proceeding – Any matter before the Board, including a petition, hearing or claim.

Secretary —The Secretary of the Board of Finance and Revenue, who is the Board officer with whom documents are filed and by whom official records are kept.

Staff—The attorneys, non-attorney tax petition reviewers and administrative personnel employed to support the Board in the performance of its duties and responsibilities.

Trade secret—Information identified by the Petitioner as and that meets the definition of a trade secret or confidential proprietary information as defined in Section 102 of Act of February 14, 2008 (P.L. 6, No. 3) known as Right-to-Know Law.

§ 1.4. Filing generally.

(a) Documents filed with the Board should be submitted in one of the following manners:

(1) In person or by mail:

Secretary of the Board
Pennsylvania Board of Finance and Revenue
1101 South Front Street, Suite 400
Harrisburg, Pennsylvania 17104-2539

(2) Electronically, at bfr@patreasury.gov.

(3) By facsimile at 717.783.4499

(b) When the Board is of the opinion that a submission for filing does not sufficiently set forth required material or is otherwise insufficient, the Board may accept it for filing and advise the person submitting it of the deficiency and require that the deficiency be corrected.

(c) The Petitioner bears the responsibility for the readability of any documents filed with the Board. The Petitioner accepts the risk that any delay, disruption, or interruption of any document filed with the Board by means Electronic Delivery may not be properly or timely filed.

§ 1.5. Board office hours.

Unless otherwise directed by the Chairman, the Board offices will be scheduled to be open from 8:00 a.m. until 4:30 p.m. on Business Days.

§ 1.6. Oaths.

A Board member or the Secretary will have the power to administer oaths or affirmations with respect to any Proceeding.

§ 1.7. Formal rules of evidence do not apply.

Formal rules of evidence do not apply to matters before the Board.

§ 1.8. Subpoenas.

The Board does not possess the power to issue subpoenas.

Subchapter B. TIME

§ 1.11. Date of filing.

(a) Whenever a Party's submission is required or permitted to be filed, it will be deemed to be filed on the earliest of the following dates:

(1) On the date actually received by the Board.

(2) On the date deposited with an IRS-designated private delivery service (as set forth in an IRS Notice - currently 2004-83), as shown on the delivery receipt attached to or included within the envelope containing the document.

(3) On the date deposited in the United States Mail as shown by the United States Postal Service stamp on the envelope or noted on a United States Postal Service Form 3817 certificate of mailing. A mailing envelope stamped by an in-house postage meter is insufficient proof of the date of mailing.

(4) When a document is submitted via Electronic Delivery on a day other than a Business Day, the document will be deemed to be filed on the next Business Day.

§ 1.12. Computation of time.

Except as otherwise provided by statute, in computing a period of time prescribed by law, the day of the act, event or default after which the designated period of time begins to run is not included. The last day of the period is included, unless it is not a Business Day, in which event the period shall run until the end of the next Business Day.

Subchapter C. REPRESENTATION BEFORE THE BOARD

§ 1.21. Representation.

(a) *Representative.* Appearances in Proceedings before the Board may be by the Petitioner or by an attorney, accountant or other representative provided the representation does not constitute the unauthorized practice of law as administered by the Pennsylvania Supreme Court.

(b) *Power of attorney.* The Board may require in any Proceeding that a power of attorney, signed and executed by the Petitioner, be filed with the Board before recognizing any person or persons as representing the Petitioner.

(c) *Notice of Petitioner's Representative.* A Petitioner or his designated representative shall file with the Secretary a Petition that includes the name of the Petitioner, and if applicable, Petitioner's representative, which will serve as notice of appearance. The Department will be deemed to be served electronically when the Board dockets the case onto the Department's appeal system.

(d) *Designated representative after petition filed.* If a Petitioner authorizes a representative after the Petition is filed, the Petitioner shall file with the Secretary a form prescribed by the Board or a letter on the Petitioner's letterhead naming the representative.

(e) *Change in representative.* A change in representative that occurs during the course of a Proceeding shall be reported promptly to the Secretary.

(f) *Change in address.* A change in address that occurs during the course of a Proceeding shall be reported promptly to the Secretary.

(g) *Withdrawal of representative.* Representation continues until a Petitioner or Petitioner's representative notifies the Secretary in writing that the designation of representation is rescinded.

§ 1.22. Limited practice before the Board.

(a) The Board may deny, temporarily or permanently, the privilege of representing a Petitioner before it in any way to a person who is found by the Board, after notice and opportunity for hearing in the matter, to have done one or more of the following:

(1) Lacked the requisite qualifications to represent others.

(2) Engaged in unethical, contemptuous or improper conduct with respect to any matter before the Board.

(3) Repeatedly failed to follow Board directives.

Subchapter D. EX PARTE COMMUNICATIONS

§ 1.31. Definitions.

The following words and terms, when used in this subchapter, have the following meaning, unless the context clearly indicates otherwise:

Communications -- Any verbal, written or electronic communication by a Party or its representative with the Board or the Staff.

Ex Parte Communication -- A Communication regarding the merits of a Petition that takes place outside of a public hearing by one Party with respect to which the other Party was not provided notice and an opportunity to participate in said Communication unless the other Party has previously provided a Waiver of its right to participate in and thereafter object to the Communication.

Waiver -- An acknowledgement to the Staff by a Party or its representative that the Party chooses not to participate in a Communication between the Staff and the other Party and agrees not to thereafter object to such Communication. Failure of a Party or its representative to participate in a Communication, for which the Party was provided notice and an opportunity to participate, shall be deemed a waiver by that Party of its right to object to such Communication. The Waiver shall be in a format as designated by the Board and published on the Board's website.

§ 1.32. General rules.

(a) *Communication with Board Members.* The Board members shall not participate in any Communications with a Party concerning the merits of a Petition pending before the Board, outside of a public hearing.

(b) *Communication with Staff.* The Staff may not participate in any Ex Parte Communications.

(c) *Written and electronic submission.* Any written or electronic submission provided to the Board or Staff by a Party must be promptly provided to the other Party.

(d) *Notification.* The Staff will make every reasonable effort to avoid Ex Parte Communications, and promptly upon discovery of an Ex Parte Communication, will notify the other Party. The Board may take any reasonable measures deemed necessary to remedy an Ex Parte Communication.

CHAPTER 2. TAX AND OTHER APPEAL PROCEEDINGS

Subchapter A. SUBMISSIONS.

§ 2.1. Petitions generally.

(a) *General requirements.* Petitions for relief must be in writing, state clearly and concisely the interest of the Petitioner in the subject matter, the facts, and the basis for relief sought.

(b) *Petition Form.* A Petition must be filed using the Board's designated petition form or otherwise conform to the format of the Board's designated form located on the Board's website.

§ 2.2. Petition content.

(a) *General.* A Petition shall include, at a minimum, all of the following that are applicable:

(1) The Petitioner's name, address, telephone number and electronic mail address.

(2) The name, address, telephone number and electronic mail address of the Petitioner's representative.

(3) The Board of Appeals docket number.

(4) The Petitioner's appropriate identifying designation, such as license number, Social Security Number, claim number, file number, or corporate box number.

(5) The appeal type and relevant periods for review.

(6) The amount of tax or other amounts Petitioner claims to have been erroneously assessed or to have been overpaid.

(7) The basis upon which the Petitioner claims that an assessment is erroneous or a refund is due.

(8) A statement of the relevant facts.

(9) A statement indicating whether a hearing before the Board is requested.

(b) *Accuracy of Address for Board Correspondence.* The Board shall be permitted to rely upon the accuracy of the physical or email address provided by the Petitioner. It shall be the duty of the Petitioner to notify the Board if there is any change in an address provided to the Board.

pennsylvania
DEPARTMENT OF REVENUE

INFORMATION NOTICE CORPORATION TAXES 2014-0X

Discussion Draft: June 16, 2014

I. PURPOSE

For purposes of determining the appropriate net income and capital stock franchise tax apportionment factors, this notice provides taxpayers with guidance on sourcing the sales of services to this Commonwealth, as defined in Act 52 of 2013, 72 P.S. § 7401 (3)2.(a)(16.1)(C). Note that sales of services are no longer subject to the income-producing activity and cost of performance rules found in subparagraph (17).

II. STATUTORY AMENDMENT

72 P.S. § 7401(3)2.(a)(16.1)(C)

Rule #1 Sales from the sale of a service are considered to be in this state, if the service is delivered to a location in this State. If the service is delivered both to a location in and outside this State, the sale is in this State based upon the percentage of total value of the service delivered to a location in this State.

Rule #2 If the state or states of assignment under Rule #1 cannot be determined for a customer who is an individual that is not a sole proprietor, a service is deemed to be delivered at the customer's billing address.

Rule #3 If the state or states of assignment under Rule #1 cannot be determined for a customer, except for a customer under Rule #2, a service is deemed to be delivered at the location from which the services were ordered in the customer's regular course of operations. If the location from which the services were ordered in the customer's regular course of operations cannot be determined, a service is deemed to be delivered at the customer's billing address.

III. APPLICATION OF THE STATUTE

1. Overview

72 P.S. § 7401(3)2.(a)(16.1)(C) provides the rules for sourcing service income for purposes of Sales Factor Apportionment. Historically, the Sales Factor represents a taxpayer's marketplace, serving as a counterbalance to the Property and Payroll Factors, which are associated with the location of production and labor. Therefore, the Sales Factor must identify the state or states in which the taxpayer has a market for the services, *i.e.*, a place where the services may be used. Moreover, identification of the market state or states in which the

services are delivered requires knowing where the users of the service are located.

2. Delivery

While Rule #1 requires sales of services be sourced to PA if the services are delivered to a location in this State, the statute does not define the word "delivered." The Department of Revenue ("Department") defines "delivery" as occurring at a location where a person or entity may use the service. This construct is necessary to avoid scenarios where a service is "delivered" to a location that merely serves as a transit point not representative of the market state where the service is used. Further, note that the party who actually pays for a service need not be the party to whom a service is delivered. Accordingly, the passage of a service from a provider to a user constitutes delivery of the service; the passage of a service from a provider to an intermediate party does not.

This definition of "delivery" is further supported by the context of subparagraph (16.1)(C), which requires that Rule #1 be employed if at all possible before resorting to Rule #2 or Rule #3. This means Rules #2 and #3 are used to default the delivery location to a purchasing or billing address, neither of which may represent the true marketplace for the service.

3. Third Party Delivery

It is not uncommon for a service to be delivered to the location of the customer by a third party. For example, an original service provider may find it cost effective to hire a third party to complete ultimate delivery of the contracted service to the customer. In this situation, delivery of the service from the customer's perspective occurs at the ultimate location where the customer can use the service.

Accordingly, whenever a customer contracts with a service provider to have services delivered directly to the customer, the service provider shall source its receipts to the customer's location of use, regardless of whether the service provider contracts with a third party to complete final delivery to the customer.

4. Electronic Delivery

Apportionment of services delivered electronically to locations in PA and one or more other states may be accomplished by using IP address records or other network data where individual street addresses of customers are not available. However, network data should be used only if it corresponds reasonably well to the estimated locations where individual customers use the service.

Note that services delivered to an electronic address (*e.g.*, an email address, FTP account or IP address) are delivered to PA if the user of the electronic service is in PA. If the user of the electronically-delivered service is both in PA and at least

one or more other states, the service is delivered to PA according to the relative proportion of use of the service in PA compared to other states.

5. Apportionment by Jurisdiction

If use of a service can occur in PA and outside of PA, it may be necessary to apportion the service to each state. In the event a service is apportioned, a reasonable and consistent method must be used. For example, apportionment may be based on "expected usage" or "actual usage" or "value of the usage;" however, whichever method is selected, the taxpayer must be consistent in using the selected method for all receipts.

IV. GUIDELINES FOR CERTAIN TYPES OF SERVICES OR SERVICE INDUSTRIES

1. Individuals Present in PA

If a service is provided to a purchaser who is an individual who is physically present in this state at the time the service is received, the service is delivered to PA.

2. Personal and Professional Services for Individuals

If a service is received in this state and is in the nature of personal services (*e.g.*, consulting, counseling, personal advice, training, speaking, and providing entertainment) that are typically conducted or performed first-hand, on a direct, one-to-one, or one-to-many basis, the service is delivered to PA, even if the service is provided from a remote location and/or delivered via electronic means.

3. Trade or Business Services

Services provided to a trade or business that are used by the trade or businesses are delivered to the location(s) where they are actually used. The term "trade or business" as used in this document shall include the administration, management, business processes, marketing, sales, manufacturing, distribution, and all other operations that support the trade or business itself. Trade or business services do not include services paid for by a trade or business that are used only by employees for reasons not related to the conduct of the trade or business.

If a service is provided to a purchaser engaged in a trade or business in PA and relates only to the trade or business of that purchaser in PA, the service is delivered to PA. If the service is provided to a purchaser engaged in a trade or business in PA, and one or more other states, and the service relates to the trade or business of that purchaser in PA and in one or more other states, the service is delivered in PA to the extent that it relates to the trade or business of the purchaser in PA.

4. Franchise and Service Fees

If a taxpayer receives payment for services provided to a franchisee, then the franchise fee receipts should be sourced to the location of where the franchisee used the services. Any separately stated charges for the use of intangible property such as trademarks should be sourced under the provisions of Section 401(17). If a franchise fee is a lump sum amount including both services and intangibles, and it is not possible to separately identify and value each intangible or service included in the fee, then the franchise fee should be sourced as a service and apportioned using an equivalent arms-length transaction, as if the taxpayer sold its service on the open market.

5. Employee Services

If a service is provided to employees of a company and the service is used by the employees for each employee's own personal benefit (*i.e.*, not primarily related to the trade or business of the company) such service is delivered in PA following the guidelines above for delivery of Personal and Professional Services for Individuals. If it is not possible for the taxpayer to ascertain or provide a reasonable estimate of the value of services delivered to employees in PA, then the delivery location of the services shall be apportioned to PA based on the number of employees assigned to PA by the purchasing company.

6. Brokerage Services

The service is delivered to PA if the home address of an individual purchasing the service is in PA. The service is delivered to PA if the principal business address of a business purchasing the service is in PA.

7. Package Delivery and Courier Services

Receipts from a delivery service are sourced to PA by a delivery service or courier when the package is delivered to an address in PA, unless the taxpayer is otherwise subject to the special apportionment rules of 72 P.S. § 7401 (3)2.(b).

8. Subscription Services

A subscription service is delivered to a location in PA if the subscription customer who actually uses the service is located in PA. If the actual physical locations of users of the subscription service cannot be easily determined, delivery of the service may be sourced, proportionately, to each state based on the number of subscribers in each state.

9. Mortgage Lending

The mortgage and any other related services shall be sourced to PA if the property subject to the mortgage is located in PA. If the property subject to the mortgage is located in PA and one or more other states, the mortgage lending

service is delivered in PA to the extent that it relates to the property located in PA.

10. Sale, Lease, Rental, or Other Use of Real Property

Sourcing of receipts for sale, lease, rental, or other use of real property shall be sourced under (16.1)(A).

11. Advertising

The act of creating an advertisement itself should be considered the creation of tangible personal property. However, the distribution and delivery of an advertisement to a target audience is considered a service. Delivery of an advertisement to a target audience is considered complete only when it reaches its intended target audience. Delivery to a target audience may follow these guidelines:

a) To the extent that an advertisement specifically targets audiences in PA, the advertisement service is considered delivered to PA.

b) To the extent that an advertisement specifically targets audiences in another state, the advertisement service is not delivered to PA.

c) To the extent an advertisement is targeted to multiple states or the location of the target audience cannot be ascertained, then a representative portion of the advertisement service is delivered to PA based on reasonable estimates of the location of the target audience.

12. Data Processing, Internet Access, Data Streaming, Data Storage and Information Services

Data processing and information services, such as streaming audio or video, access to stored data, or corporate shared services are delivered to the location of the user of such services.

Delivery of data services to a server, "the cloud," or other data storage device does not constitute delivery of these types of services. Rather, such services are considered delivered to the location of the user.

If the users of stored data are third parties, such as public web site users whose physical addresses are unknown to the cloud storage company, receipts may be sourced using IP addresses or other network data.

Receipts from providing Internet access service are sourced to PA to the extent the access service is used by a customer in PA.

13. Computer Software

Computer software, whether it involves tangible personal property, canned software, custom software, or a license to use a type of software, is sourced to PA if the user of the software is located in PA.

The development of computer software for a purchaser is considered a service if the purchaser provides specifications that make the resulting software unique to that purchaser. Such service is delivered to PA if the purchaser uses the software in PA, regardless of whether the software resides on an internet or email server, hard medium such as a DVD, flash drive, or other physical device, or on "the cloud" and is located outside of PA. If the service is utilized both in PA and another state, the software is delivered to PA to the extent it is used in this state relative to use in other states.

14. Construction Services, Landscaping Services

If a service relates to real property that is located entirely in this state then the service is sourced to PA. If the service relates to real property that is located in this state and in one or more other states, the service is delivered to PA to the extent that the real property is located in PA.

15. Transportation

Railroads, motor carriers, bus lines, airlines, and other transportation companies shall continue to apportion income under the rules of 72 P.S. § 7401 (3)2.(b).

16. Pipeline or Natural Gas Companies

Pipeline or natural gas companies shall continue to apportion income under the rules of 72 P.S. § 7401 (3)2.(c).

17. Water Transportation Companies

Water transportation companies shall continue to apportion income under the rules of 72 P.S. § 7401 (3)2.(d).

18. Telecommunications

Companies with receipts subject to the federal Mobile Telecommunications Souring Act (MTSA) shall source those receipts in accordance with MTSA rules, which sources the receipts to the "place of primary use," which is often the billing address of the customer. Telecommunications companies not subject to the federal MTSA and CATV companies, are delivered to a location in this Commonwealth if the service address of the account is in this Commonwealth. If the service is delivered to an individual or business with service accounts in the Commonwealth and at least one other state, the service is delivered in this

Commonwealth based on the proportion of service locations in this Commonwealth compared to service locations in other states.

19. Utilities

This general utility rule applies only to utilities not identified elsewhere in this Notice. Delivery of a utility service occurs in PA if the service address is in PA. The transportation of a tangible item related to such service may be considered a separate service if separate receipts are provided for the actual transportation of the tangible and for the physical amount of the tangible delivered to a customer's service address.

V. EXAMPLES, BY RULE NUMBER

NOTE: The examples below are for general guidance only and are binding on neither the Commonwealth nor a particular taxpayer.

Rule #1

a) Example: Taxpayer constructs a building in New Jersey for a PA-based customer. No receipts are sourced to PA.

b) Example: PA-based Taxpayer provides internet access to a customer's PA-based location. All receipts are sourced to PA.

c) Example: Taxpayer develops and analyzes X-Ray film in Kansas for delivery to a doctor in PA. All receipts are sourced to PA.

d) Example: Taxpayer conducts Research and Development activities in Idaho for a PA company's use in PA. All receipts are sourced to PA.

e) Example: PA-based Taxpayer performs R&D for Customer, who has affiliates in PA, Ohio, and 15 other states. The R&D report is ordered by, billed to, and physically delivered to the Ohio purchasing office, which does not engage in any activities related to R&D. Taxpayer's receipts are sourced to PA to the extent the value of the reports is used in PA. If it is impossible for Taxpayer to reasonably estimate the service value delivered to any particular state, then Taxpayer's receipts are sourced according to Rule #3.

f) Example: Taxpayer, based in PA, operates beauty salons in PA and New Jersey. Receipts from salon services performed at Taxpayer's locations in PA are sourced to PA. Receipts from salon services performed in New Jersey are sourced to NJ, where customers receive the service.

g) Example: Taxpayer provides office cleaning services to a customer who has one location in PA and two locations in Ohio. The sales contract provides one charge for cleaning the three locations. Receipts are sourced to PA by a fraction,

which is service value at the PA location divided by total service value for the three locations.

h) PA-based Drake's Dry Cleaners provides cleaning services for shirts, dresses, pants, and coats. However, Drake outsources the cleaning of leather coats to Ohio-based Lenny's Leather Cleaners. Customer Carl comes to Drake with a leather coat in need of cleaning. Drake delivers the leather coat to Lenny for special cleaning. Lenny cleans the coat, returns it to Drake, and bills Drake for the service. Carl picks up his cleaned leather coat at Drake's store and pays Drake for the cost of cleaning the coat. Drake sources the receipt from Carl to PA, the location where Carl took possession. Lenny sources his receipt from Drake to PA because his contract was with Drake and he completed his service and delivery by delivering it to Drake in PA.

i) Example: PA-based Customer orders a service from Taxpayer based in Virginia. Customer's purchase office in New Jersey actually places the order on behalf of the PA Office. Taxpayer delivers the service output to Customer's New Jersey Office. Customer's New Jersey Office delivers service output to the PA Office. The service receipts are sourced to PA.

j) Example: Taxpayer is a New York-based investment & mutual fund company. Taxpayer provides a common, uniform benefit program for the employees of PA-based A Corp. Two-thirds of A Corp's employees reside in PA and one-third resides in Ohio. Two-thirds of Taxpayer's gross receipts are sourced to PA.

k) Example: Taxpayer is a PA-based law firm. Taxpayer prepares a PA property deed for Company A, a multi-state company commercially domiciled in PA. Taxpayer mails the property deed to an office of Company A in Delaware. The receipts from this service will be assigned to PA despite the property deed having been mailed to a Delaware address, because the services are of value only in PA.

l) Example: Taxpayer is a PA-based CPA firm that provides tax preparation services to Company A, who is also based in PA. Company A has income from services performed in New Jersey. Taxpayer prepares a New Jersey State Income Tax return for Company A. Receipts for this service are sourced to PA.

m) Example: Taxpayer is a provider of third-party payroll processing services for Company A. Half of Company A's employees are located in PA and half are located in New York. Company A's headquarters and human resources functions are located in PA. Taxpayer sources all of the payroll services to PA. Note in this example that payroll services are really used by the corporation and not the employee because the service is designed to meet the needs of the company, and it is the company that uses the processing service, not the employee.

Rule #2

Example: Taxpayer provides worldwide traveler emergency and advice service via phone to individuals located throughout the United States. Customers may call for assistance from any phone in the world. Taxpayer sources service receipts to PA for all customers with PA billing addresses.

Rule #3

Example: Taxpayer provides phone and Internet-based drug and alcohol crisis and rehabilitation services to employees of Company A, whose headquarters is in Ohio but who has 40% of its employees in Ohio and 60% in PA. Employees may request counselling by calling a phone number or logging in to a Web Page. Employees may use the service anonymously, and are not charged an individual fee to use the service. Company is charged an annual service fee by Taxpayer. None of Taxpayer's receipts are sourced to PA.

VI. APPORTIONMENT OF INTANGIBLES

1. Intangible Property

Intangible property means any of the following.

- Patents, copyrights, trademarks, and trade names.
- Money and instruments representing the ownership of money.
- Equity or debt securities, such as stocks and bonds, and derivatives of such securities.
- Credits such as tax credits, energy credits, and billing credits.

Receipts from intangibles include any of the following.

- Royalties for the use of intangible property.
- Interest, capital gains or dividends arising from the ownership, sale, exchange or other disposition of intangible property.

In cases where it is uncertain whether a receipt represents income from an intangible or from a service, and in cases where a receipt contains both items related to services and items related to intangibles, the receipt should be sourced according to the sourcing of services rules provided in 72 P.S. § 7401(3)2.(a)(16.1)(C).

2. Application of Income Producing Activity Law

Section (17) of 72 P.S. § 7401 has been amended to restrict the use of "income-producing" activity apportionment to receipts from intangibles only:

> (17) Sales, other than sales under paragraphs (16) and (16.1), are in this State if:
>
> (A) The income-producing activity is performed in this State; or
>
> (B) The income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other state, based on costs of performance.

Intangibles income will continue to be apportioned to PA if the income producing activity is performed in this state, using Subparagraph (17)(a). While Pennsylvania law does not define the term "perform," the common meaning of the term is defined in Black's Law Dictionary as "[t]o perform an obligation or contract is to execute, fulfill or accomplish it according to its terms." Black's further defines "performance" as [t]he fulfillment or accomplishment of a promise, contract, or other obligation according to its terms." Accordingly, performance of the income producing activity occurs when the performance is accomplished or fulfilled. The department has consistently applied the income producing activity rule focused on fulfillment of the sale to the customer. Such application has been uniform for both PA-based and non PA-based taxpayers.

In instances where the income producing activity of a single transaction takes place in more than one state, then it may be necessary to use the costs of performance method (17)(b) for assigning the sales activity to a particular state. In calculating the costs of performance in each state, the taxpayer may include only those costs related to income-producing activities that are directly responsible for income generation in PA. The taxpayer must specifically identify each claimed income producing activity and must justify how each income producing activity directly affects the production of income in PA.

Finally, if a taxpayer cannot establish the location of the income producing activity, the income producing activity will be assumed to have occurred both within PA and outside of PA, with the greater proportion of the costs of performance occurring in PA.

Example

Taxpayer is a Maryland-based restaurant chain that grants franchises to individuals in specific locations throughout Maryland and Pennsylvania. In exchange for granting a franchise to an individual, Taxpayer leases its trademarks and patented food-processing techniques to its franchisees. The leases are paid annually and entitle the franchisee to use those intangibles in

specific restaurants throughout Pennsylvania and Maryland. The receipts from intangibles leased to Pennsylvania-based franchisees are sourced to Pennsylvania because the income-producing activity (use of the intangible) occurs in Pennsylvania.

2018

PICPA CONFERENCE ON PA TAXES

"You've Been Notified" – How to Avoid or Respond to PADOR Notices

James M. Brower, CPA, MST (Malvern)
Harvey Danowitz, CPA (Harrisburg)
Charles Potter, JD, CPA (Cranberry)

PICPA
Belong. Grow. Achieve.

Why Am I Getting This Letter/Notice?

How Can I Avoid It?

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Diane Zilka,	:	
	:	
Appellant	:	
	:	
v.	:	No. 1063 C.D. 2019
	:	No. 1064 C.D. 2019
Tax Review Board City of Philadelphia	:	Argued: February 10, 2021
	:	

BEFORE: HONORABLE P. KEVIN BROBSON, President Judge[1]
HONORABLE MARY HANNAH LEAVITT, Judge[2]
HONORABLE PATRICIA A. McCULLOUGH, Judge
HONORABLE ANNE E. COVEY, Judge
HONORABLE MICHAEL H. WOJCIK, Judge
HONORABLE CHRISTINE FIZZANO CANNON, Judge
HONORABLE ELLEN CEISLER, Judge

OPINION NOT REPORTED

MEMORANDUM OPINION
BY JUDGE WOJCIK

FILED: January 7, 2022

In these consolidated cases, Diane Zilka (Taxpayer) appeals the orders of the Philadelphia County Court of Common Pleas (trial court) affirming the decisions of the City of Philadelphia's (Philadelphia) Tax Review Board (Board) that denied her petitions seeking a refund of the Philadelphia Wage Tax paid on her

[1] The Court reached the decision in this case prior to the conclusion of President Judge Emeritus Brobson's service on the Commonwealth Court.

[2] This matter was assigned to the panel before January 3, 2022, when President Judge Emerita Leavitt became a senior judge on the Court.

income for the taxable periods of January 1, 2013, to December 31, 2015, and January 1, 2016, to December 31, 2016. Taxpayer argues that she is entitled to a refund to avoid unconstitutional double taxation on the same income caused by the Philadelphia Wage Tax. Discerning no error, we affirm.

I. Background

Taxpayer is a resident of Philadelphia, Pennsylvania, but during the tax years at issue, she worked full time in Wilmington, Delaware. In April 2017 and June 2017, Taxpayer filed petitions with the Philadelphia Department of Revenue (Department) seeking refunds for Philadelphia Wage Taxes paid from 2013 through 2015 and 2016, respectively. During those tax periods, Taxpayer's Delaware employer withheld the following taxes: Philadelphia Wage Tax, Wilmington Earned Income Tax (Wilmington Tax), Pennsylvania Income Tax (Pennsylvania Tax), and Delaware Income Tax (Delaware Tax). Taxpayer claimed a credit for the Delaware Tax (5%) to offset the Pennsylvania Tax (3.07%) on her Pennsylvania Personal Income Tax (PIT) return; Pennsylvania allowed a full credit. Taxpayer also claimed a credit for the Wilmington Tax (1.25%) and the balance of the Delaware Tax (5% - 3.07% = 1.93%) to offset the Philadelphia Wage Tax (3.92%).[3] The Department allowed a credit for the Wilmington Tax against the Philadelphia Wage Tax but not for the remainder of the Delaware Tax.

Taxpayer appealed to the Board challenging the Department's denials as to both tax periods on the basis that she was entitled to a refund for a portion of the unused Delaware Tax credits. Taxpayer argued that she was taxed, on average,

---

[3] Taxpayer and Philadelphia both utilized percentages and calculations from the 2014 tax year as the primary example in their briefs. For sake of simplicity, this Court has done the same. The 2014 tax year is representative of the other years, albeit slight variations exist.

1.93% higher than her intrastate counterparts. Taxpayer claimed that the Department's refusal to apply the remainder of the Delaware Tax as credit against the Philadelphia Wage Tax amounted to an unconstitutional burden on interstate commerce. The Board denied her appeals, and the trial court affirmed without taking additional evidence. Taxpayer appealed both decisions to this Court, which we have consolidated for review.[4]

II. Issues

Before this Court, Taxpayer argues that the trial court erred by denying her a credit against her Philadelphia Wage Taxes for the portion of income taxes that she paid to Delaware, which was not credited against her income taxes paid to Pennsylvania. Taxpayer contends that the failure to award a credit amounts to double taxation in violation of the Commerce Clause, U.S. Const. art. 1, §8, cl. 3.

According to Taxpayer, she was taxed four times on the same income by Pennsylvania, Philadelphia, Delaware and Wilmington. The Department's "policy"[5] is to refund similar taxes withheld by other *local* jurisdictions, but not by other *states*. By failing to apply the remainder of the taxes withheld by Delaware (after the offset applied by Pennsylvania) to offset her Philadelphia Wage Tax, she

---

[4] Where, as here, the trial court took no additional evidence, our review is limited to determining whether constitutional rights were violated, whether an error of law was committed, or whether the Board's findings of fact are supported by substantial evidence. Section 754(b) of the Administrative Agency Law, 2 Pa. C.S. §754(b); *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia*, 823 A.2d 108, 118 (Pa. 2003). Because the issue in this case is a question of law, our scope of review is plenary. *Philadelphia Eagles*, 823 A.2d at 118.

[5] Taxpayer takes issue with the fact that the Department's policy is not a formal written policy, but a practice. Appellant's Brief at 8-9, 9 n.6. However, the manner in which the Department applied the tax credits, whether pursuant to a formal written "policy" or an informal "practice," is irrelevant for a Commerce Clause analysis.

maintains that the Philadelphia Wage Tax and the tax scheme fail the test set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), in two ways. First, the tax is not fairly apportioned because it fails to provide a mechanism to mitigate the risk of duplicative taxation for income earned from interstate commerce and fails to meet the internal and external consistency tests. The Philadelphia Wage Tax does not meet the internal consistency test because it taxes interstate wages at a higher rate than intrastate wages. It does not meet the external consistency test because the tax "reaches beyond" that portion of the value fairly attributable to economic activity in the taxing state. Taxpayer conducted no business in Philadelphia; she simply resided there during the tax years at issue. There is no connection between Philadelphia and the activity being taxed. Second, Philadelphia's partial credit practice discriminates against her because she pays more in tax than her intrastate counterparts. In support of her position, Taxpayer relies heavily on *Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015), in which the United States Supreme Court applied the *Complete Auto* test and invalidated a similar tax scheme under the Commerce Clause.

III. Discussion

A. Commerce Clause - Double Taxation

The Commerce Clause grants Congress the power to "regulate Commerce . . . among the several States." U.S. Const. art. 1, §8, cl. 3. "Although the Clause is framed as a positive grant of power to Congress," the United States Supreme Court has "'consistently held this language to contain a further, negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject.'" *Wynne*, 575 U.S. at 549 (quoting *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S.

175, 179 (1995)). Under the dormant Commerce Clause, States "'may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State.'" *Id.* (quoting *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984)). "'Nor may a State impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business, or by subjecting interstate commerce to the burden of 'multiple taxation.'" *Id.* at 549-50 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)). In short, the Commerce Clause forbids double taxation. *Id.* at 550-51; *see, e.g.*, *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 660 (1948) (New York tax scheme that sought to tax a portion of a domiciliary bus company's gross receipts that were derived from services provided in neighboring States violated dormant Commerce Clause because it imposed an "unfair burden" on interstate commerce); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939) (Washington state's tax on income that a corporation earned in shipping fruit from Washington to other States and foreign countries discriminated against interstate commerce because the scheme did not similarly expose local commerce to the tax burden); *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307 (1938) (State income tax on a corporation's out-of-state sales violated the dormant Commerce Clause by subjecting interstate commerce to double taxation but not intrastate commerce).

Upon review, Taxpayer's income is not being doubly taxed. Taxpayer never pays more than one local tax or more than one state tax. In other words, Philadelphia is not taxing Taxpayer's income "more heavily when it crosses state lines than when it occurs entirely within the State." *Wynne*, 575 U.S. at 549. Rather, Philadelphia is taxing Taxpayer the same as other residents who worked intrastate –

3.92%. Although we recognize that Taxpayer pays 1.93% more than her intrastate counterparts, that is because Taxpayer chose to work in Delaware, *which charges a higher income tax than Pennsylvania*. As the trial court recognized, Delaware's higher income tax "is neither unconstitutional, nor attributable to any unconstitutional action taken by . . . Philadelphia." Trial Court Op., 8/28/2019, at 5. While Wilmington charges less than Philadelphia, Philadelphia credited 100% of the Wilmington Tax to offset the Philadelphia Wage Tax. The fact that Philadelphia chose not to additionally apply credit for the "unused" balance of the Delaware Tax towards its Wage Tax does not amount to double taxation. *See Wynne*. Assuming the risk that a double tax burden may exist, we examine whether the Philadelphia Wage Tax withstands the constitutional test set forth in *Complete Auto*.

B. *Complete Auto*

Complete Auto is the seminal United States Supreme Court case addressing the applicability of the Commerce Clause to state and local taxation. In *Complete Auto*, the Court fashioned a four-prong test to determine whether a state or local tax unconstitutionally burdens interstate commerce. 430 U.S. at 279. The test requires: (1) the activity must have a substantial nexus with the taxing district; (2) the tax must be fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) there must be a reasonable relationship between the tax imposed upon the taxpayer and the services provided by the taxing district. *Id.* Failure to meet any one prong renders the tax unconstitutional. *Id.* Our focus here is on the second and third prongs.

1. Second Prong - Fair Apportionment

The second prong of the *Complete Auto* test "'ensures that each State taxes only its fair share of an interstate transaction.'" *Jefferson Lines, Inc.*, 514 U.S. at 184 (quoting *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989)). The purpose is to eliminate the "danger of interstate commerce being smothered by cumulative taxes of several states." *Complete Auto*, 430 U.S. 277 (citation omitted). We determine whether a tax on interstate commerce is fairly apportioned by examining whether it is internally and externally consistent. *Jefferson Lines*, 514 U.S. at 185 (quoting *Goldberg*, 488 U.S. at 261).

a. Internal Consistency

The internal consistency test "'looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.'" *Wynne*, 575 U.S. at 562 (quoting *Jefferson Lines*, 514 U.S. at 185). The test helps courts identify tax schemes that discriminate against interstate commerce. *Id.* Assuming that every State has the same uniform tax scheme, all states would grant a credit that precisely reduces the taxpayers' in-state tax to the same amount they would pay if they earned all that income in-state. *See id.* Such a scheme would add no burden to interstate commerce that intrastate commerce would not also bear. *See id.*

"Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause," it is not required. *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 279 (1978). The dormant Commerce Clause does not prohibit jurisdictions from using different tax formulas; rather, it prohibits discrimination that "inhere[s] in either State's formula." *Id.* at 277 n.12.

In other words, there is no "discriminat[ion] against interstate commerce" where the alleged taxation disparities are "the consequence of the combined effect" of two otherwise lawful income tax schemes. *Id.*

The United States Supreme Court has repeatedly held that the internal consistency test is met by a system of credits, which exempts the taxpayer to the extent that he or she has already paid the same tax in another state. *See Jefferson Lines*, 514 U.S. at 185; *Goldberg*, 488 U.S. at 262; *see also Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 483 U.S. 232, 245 n.13 (1987) (noting that "[m]any States provide tax credits that alleviate or eliminate the potential multiple taxation that results when two or more sovereigns have jurisdiction to tax parts of the same chain of commercial events").

Applied here, the Philadelphia Wage Tax meets the internal consistency test. If every jurisdiction imposed a tax scheme identical to Philadelphia's, all individuals earning income outside of their home locality would receive a credit for income taxes paid to the foreign locality and would pay no more than their intrastate counterpart. Any additional tax owed by the interstate taxpayer simply results from the higher tax rate charged on the income by the foreign state. Such consequence does not render Philadelphia's tax formula discriminatory under the internal consistency test. *See Moorman*.

b. External Consistency

Next, even if a tax is internally consistent, it must also meet the second component of fair apportionment, *i.e.*, external consistency. *Jefferson Lines*, 514 U.S. at 184. External consistency examines "the economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond

that portion of value that is fairly attributable to economic activity within the taxing State." *Id.* at 185 (citing *Goldberg*, 488 U.S. at 262). "[T]he threat of real multiple taxation (though not by literally identical statutes) may indicate a State's impermissible overreaching." *Id.*

The Philadelphia Wage Tax meets the external consistency test. The Philadelphia Wage Tax reasonably reflects how and where Taxpayer's income is generated – in Wilmington, Delaware. The Philadelphia Wage Tax is not taxing all of Taxpayer's income regardless of source. Rather, Philadelphia fairly apportions the tax according to its relation to the income by providing a credit for the tax owed to Wilmington. Philadelphia avoided taxing more than its fair share of Taxpayer's wages by providing a tax credit for 100% of the Wilmington Tax. As for Taxpayer's challenge that Philadelphia has no right to tax her out-of-state income, Philadelphia's provision of municipal benefits and services to its residents provides sufficient economic justification for the imposition of its Wage Tax. *Lawrence v. State Tax Commission of Mississippi*, 286 U.S. 276, 279 (1932) (recognizing that "domicile in itself establishes a basis for taxation. Enjoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government.").

2. Third Prong – Discrimination

A State may not "impose a tax [that] discriminates against interstate commerce either by providing a direct commercial advantage to local business . . . or by subjecting interstate commerce to the burden of 'multiple taxation.'" *Wynne*, 575 U.S. at 549-50 (quoting *Northwestern States*, 358 U.S. at 458) (citations omitted); *accord Jefferson Lines*, 514 U.S. at 197. "Thus, States are barred from

discriminating against foreign enterprises competing with local business . . . and from discriminating against commercial activity occurring outside the taxing State[.]" *Jefferson Lines*, 514 U.S. at 197 (citations omitted).

Here, Philadelphia taxes all of its residents' income at the rate of 3.92%. It also permits a full credit for any similar taxes paid to other jurisdictions. Because Taxpayer's income was subject to the 1.25% Wilmington Tax, Philadelphia applied 1.25% credit toward her Philadelphia Wage Tax. Consequently, Taxpayer is not paying income tax twice on her interstate income. Rather, Taxpayer is paying the same 3.92% rate as her Philadelphia counterparts. The difference is that Philadelphia is receiving only 2.67%, while Wilmington is receiving 1.25%. By extending a full credit for taxes paid to Wilmington, Taxpayer's income is not subject to double taxation. There is no disparate treatment or discrimination between Taxpayer and other resident taxpayers of Philadelphia. Thus, the Philadelphia Wage Tax does not discriminate against Taxpayer.

C. *Wynne*

Wynne illustrates the application of the *Complete Auto* test. In *Wynne*, the United States Supreme Court analyzed the constitutionality of Maryland's personal income tax scheme to determine whether it discriminated in favor of intrastate over interstate economic activity. *Wynne*, 575 U.S. at 545. Maryland residents were subject to a two-part income tax: (1) a "state" income tax; and (2) a "county" income tax. *Id.* Residents who paid income tax to another jurisdiction for income earned in that jurisdiction were allowed a credit against the "state" tax, but not the "county" tax. *Id.* at 545-46. Despite the assigned name, the "county" tax was a state tax because it was collected by the Maryland State Comptroller of the

Treasury. *Id.* at 546. Consequently, part of the income that a Maryland resident earned outside of the State could be taxed twice. *Id.*

The Wynnes were Maryland residents who earned pass-through income from a Subchapter S corporation that earned income in 39 States. *Wynne*, 575 U.S. at 546-47. When filing their Maryland income taxes, the Wynnes claimed an income tax credit for the taxes paid to the other 39 States. *Id.* at 547. The Maryland State Comptroller of the Treasury allowed the Wynnes a credit against their "state" income tax, but not against their "county" income tax. *Id.* The Wynnes challenged the tax scheme as double taxation. The United States Supreme Court agreed. *Id.*

The *Wynne* Court opined that, pursuant to the Commerce Clause of the United States Constitution, a State may not impose a tax that discriminates against interstate commerce either by providing a direct commercial advantage to local business or by subjecting interstate commerce to the burden of multiple taxation. *Wynne*, 575 U.S. at 549-50. The *Wynne* Court examined tax schemes that it had previously found to be unconstitutional because they "had the potential to result in the discriminatory double taxation of income earned out of state and created a powerful incentive to engage in intrastate rather than interstate economic activity." *Id.* at 561; *see, e.g.*, *Central Greyhound Lines*; *Gwin, White & Prince*; *J.D. Adams*. The *Wynne* Court noted that the tax schemes in the aforementioned three cases "could be cured by taxes that satisfy . . . the 'internal consistency' test." *Id.* at 561-62 (quoting *Jefferson Lines*, 514 U.S. at 18).

The *Wynne* Court opined that for a tax to satisfy the internal consistency test, there must be a credit for similar taxes paid by a resident taxpayer to other jurisdictions based on income earned there. *Wynne*, 575 U.S. at 561-62. Otherwise, the tax amounts to a tariff, "which is fatal because tariffs are '[t]he paradigmatic

example of a law discriminating against interstate commerce.'" *Id.* at 565 (quoting *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1994)). The Court illustrated:

> Assume that every State imposed the following taxes, which are similar to Maryland's "county" and "special nonresident" taxes: (1) a 1.25% tax on income that residents earn in State, (2) a 1.25% tax on income that residents earn in other jurisdictions, and (3) a 1.25% tax on income that nonresidents earn in State. Assume further that two taxpayers, April and Bob, both live in State A, but that April earns her income in State A whereas Bob earns his income in State B. In this circumstance, Bob will pay more income tax than April solely because he earns income interstate. Specifically, April will have to pay a 1.25% tax only once, to State A. But Bob will have to pay a 1.25% tax twice: once to State A, where he resides, and once to State B, where he earns the income.

Id. at 567-68.

The flaw in Maryland's personal income tax scheme was that it imposed a "county" income tax without any credit for similar income taxes paid by resident taxpayers to other states based on income earned in those states. *Wynne*, 575 U.S. at 564-65. The scheme resulted in double taxation of some income earned by Maryland residents outside the state. *Id.* at 565. The *Wynne* Court emphasized that the "Maryland scheme's discriminatory treatment of interstate commerce is not *simply the result of its interaction with the taxing schemes of other States*." *Id.* (emphasis added). Instead, the Court ruled that Maryland's tax scheme was inherently discriminatory and operated as a tariff in violation of the Commerce Clause. *Id.*

Notably, the *Wynne* Court explained that "Maryland could remedy the infirmity in its tax scheme by offering, as most States do, a credit against income

taxes paid to other States . . . . If it did, Maryland's tax scheme would survive the internal consistency test and would not be inherently discriminatory." *Wynne*, 575 U.S. at 568. The Court then tweaked its hypothetical:

> [A]ssume that all States impose a 1.25% tax on all three categories of income but also allow a credit against income taxes that residents pay to other jurisdictions. In that circumstance, April (who lives and works in State A) and Bob (who lives in State A but works in State B) would pay the same tax. Specifically, April would pay a 1.25% tax only once (to State A), and Bob would pay a 1.25% tax only once (to State B, because State A would give him a credit against the tax he paid to State B).

Id. at 568.

Although factually distinguishable, *Wynne* is instructive here. *Wynne* specifically recognized that a constitutional infirmity of double taxation can be avoided by offering a credit against similar income taxes paid out of state. Philadelphia did just that by providing a full credit for the Wilmington Tax, which is similar to the Philadelphia Wage Tax, just as Pennsylvania provided a credit for the Delaware Tax.

Contrary to Taxpayer's assertions, *Wynne* does not compel Philadelphia to apply an additional credit for any dissimilar taxes, such as the Delaware Tax or otherwise aggregate of tax credits. Although the *Wynne* Court held that Maryland was required to offset its so-called "county" tax against other "state" taxes, the "county" tax was actually a state tax because it was administered, adopted, mandated, and collected by the state. Here, both the Philadelphia Wage Tax and Wilmington Tax are municipal taxes. As the trial court aptly observed, it is a "simple 'apples to apples' approach – state taxes to state taxes and local taxes to local taxes."

Reproduced Record at 89a. Based upon our reading of *Wynne*, such an approach is reasonable and passes constitutional muster.

Although we understand that Taxpayer pays more than her intrastate counterparts, such is not the result of an unconstitutional tax scheme. Rather, it is simply the "result of the interaction of two different but nondiscriminatory and internally consistent schemes." *Wynne*, 575 U.S. at 562. Taxpayer chose to work in a jurisdiction with a higher tax rate. Philadelphia is not responsible for the fact that Delaware charges 1.93% more than Pennsylvania. Consequently, even after Philadelphia and Pennsylvania applied credits to corresponding income taxes paid to Wilmington and Delaware, respectively, Taxpayer's income was subject to a higher tax rate because of tax disparities that exist between the taxing districts, not because of a discriminatory policy or practice. In short, Taxpayer is not paying income tax twice on her interstate income. There is no support for Taxpayer's position that local and state taxes must be aggregated for Commerce Clause purposes. Philadelphia and Pennsylvania are two distinct taxing jurisdictions administering two distinct taxes to two different sets of citizenry.

IV. Conclusion

Upon review, because Philadelphia fully credited income tax withheld for the Wilmington Tax, Philadelphia's refusal to additionally credit the remaining income tax withheld for the Delaware Tax does not amount to double taxation. Accordingly, we affirm the orders of the trial court.

MICHAEL H. WOJCIK, Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Diane Zilka,	:	
	:	
Appellant	:	
	:	
v.	:	No. 1063 C.D. 2019
	:	No. 1064 C.D. 2019
Tax Review Board City of Philadelphia	:	
	:	

ORDER

AND NOW, this 7th day of January, 2022, the orders of the Court of Common Pleas of Philadelphia County, dated June 26, 2019, are AFFIRMED.

MICHAEL H. WOJCIK, Judge